

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
BASIC FINANCIAL STATEMENTS
AND SINGLE AUDIT REPORTS
FOR THE YEAR ENDED JUNE 30, 2011

ESCUELA DE ARTES PLASTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
BASIC FINANCIAL STATEMENTS
AND SINGLE AUDIT REPORTS
FOR THE YEAR ENDED JUNE 30, 2011

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**ESCUELA DE ARTES PLASTICAS DE PUERTO RICO
 (A Component Unit of the Commonwealth of Puerto Rico)
 BASIC FINANCIAL STATEMENTS
 AND SINGLE AUDIT REPORTS
 FOR THE YEAR ENDED JUNE 30, 2011**

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INDEPENDENT AUDITOR'S REPORTS

ESCUELA DE ARTES PLASTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Escuela de Artes Plásticas de Puerto Rico (the School) (a component unit of the Commonwealth of Puerto Rico), as of and for the year ended June 30, 2011, which collectively comprise the School's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School'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 basic 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Escuela de Artes Plásticas de Puerto Rico, as of June 30, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2011 on our consideration of the School'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico

The management's discussion and analysis and budgetary comparison information on pages 3 through 11 and 36 through 38, are not a required part of the basic financial statements, but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Escuela de Artes Plásticas de Puerto Rico's basic 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 basic financial statements. The schedule of expenditures of federal awards has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Rodríguez & Espada, CPA PSC

November 14, 2011
The CPA stamp number 2620299
was affixed to the original of this report.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
MANAGEMENT' S DISCUSSION AND ANALYSIS
AS OF AND FOR THE FISCAL YEAR ENDED JUNE 30, 2011

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussions and analysis of the Escuela de Plásticas de Puerto Rico provides an overview of the financial performance and the activities for the fiscal year ended June 30, 2011.

The discussion and analysis is an introduction to the School's basic financial statements, which comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report also contains other supplementary information in addition to the basic financial statements.

This report includes government-wide financial statements as required by GASB Statements 34 already implemented by the School.

Government- wide Statements (Reporting the School as Whole)

The Statements of Net Assets and Statement of Activities are two financial statements that report information about the School, as a whole, and about its activities that should help answer this question: Is the School, as a whole, better off or worse off as a results of this year's activities? These statements include all non-fiduciary assets and liabilities using the accrual basis of accounting. The current year's revenue and expense are taken into account regardless of when cash is received or paid.

The Statement of Net Assets (page 12) presents all of the School's assets and liabilities, with the difference between the two reported as "net assets". Over time, increases and decreases in net assets is an indicator of whether the School's financial position is improving or deteriorating.

The Statement of Activities (page 13) presents information showing how the School's net assets changed during the fiscal year. All changes in net assets are reported when the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Therefore, revenues and expense are reported in the statements for some items that will only result in cash flows in the future fiscal periods.

Fund Financial Statements (Reporting the School's Major Funds)

The funds financial statements provide detailed information about the major individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts the School uses to keep track of specific sources of funding and spending for a particular purpose.

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

Governmental Funds

All the School's basic services are reported in the governmental funds, which focus in how money flows into and out of those funds and the balances left at year-end that are available for future spending. Consequently, the governmental fund financial statements provide a detailed short-term view of the School general operation and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the School's programs. These funds are reported using modified accrual basis of accounting, which measures cash and all other financial assets that can readily be converted to cash. Under this method, revenues are recognized when measurable and available. Expenditures are generally recognized when the related fund liability is incurred. This is the manner in which these funds are normally budgeted. Since the governmental fund statements are presented on a different measurement focus and basis of accounting than governmental-wide statements, two schedules are presented which briefly explains the adjustments necessary to reconcile the fund statements with the governmental wide statements.

- Governmental funds include the General Fund and Other Governmental funds that accounts for resources provided under federal grants and local special assignment funds legally restricted for expenditures for education programs oriented to plastic arts.
- Governmental funds also employ encumbrance accounting. Under the encumbrance system, all purchase orders; contracts and other commitments for the expenditure of funds are recorded in order to reserve that portion of the applicable appropriation.

Additional Required Supplementary Information

Following the basis financial statements is additional Required Supplementary Information that further explains and supports the information in the financial statements.

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

HIGHLIGHTS

Government-wide:

- The assets of the School exceeded its liabilities at the close of the fiscal year by \$9,835,482 (reported as net assets).

Fund Level:

- As of the close of the fiscal year, the School's governmental funds reported combined ending fund balances of \$2,491,597.

FINANCIAL ANALYSIS OF THE GOVERNMENT AS A WHOLE

The School's net assets decreased by \$829,466 over the course of this year's operations due primarily to a decrease in Operating grants and increase in Payroll and related costs due to the early retirement benefits effect (Act 70) applied during this year. The School recorded its long-term liabilities related to compensated absences such as vacation and sick leave, and the capital assets and their corresponding accumulated depreciation and expense and the effect of early retirement benefits, in accordance with the GASB. The School's net assets at the end of the fiscal year ended on June 30, 2011 were \$9,835,482. (See table below).

	CONDENSED Statement of Net Assets as of June 30, 2011	CONDENSED Statement of Net Assets as of June 30, 2010	Change	%
ASSETS				
Cash and other assets	\$2,895,561	\$3,625,666	\$(730,105)	(20%)
Capital assets, net	8,292,654	8,208,373	84,281	1%
Total Assets	11,188,215	11,834,039	\$(645,824)	(5%)
LIABILITIES				
Liabilities	\$1,352,733	\$1,437,777	\$ (85,044)	(6%)
Total Liabilities	1,352,733	1,437,777	(85,044)	(6%)

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

	CONDENSED Statement of Net Assets as of June 30, 2011	CONDENSED Statement of Net Assets as of June 30, 2010	Change	%
Net Assets:				
Investment in capital assets	8,292,654	8,208,373	84,281	1%
Restricted	1,312,584	905,165	407,419	45%
Unrestricted	230,244	1,282,723	(1,052,479)	(82%)
Total Net Assets	\$9,835,482	\$10,396,261	\$ (560,779)	(36%)

The largest component of the School's net assets as of June 30, 2011 represents its investment in capital assets (e.g. building , building improvements, furniture and fixtures, other equipment, computers, software's and motor vehicles, less the related accumulated depreciation). Consequently, unrestricted net assets showed a \$230,244 balance at the end of this year.

The following financial information was derived from the government-wide Statement of Activities for fiscal year ended June 30, 2011 and reflects how the School's net assets changed:

	CONDENSED Statement of Activities			
	Fiscal Year Ending June 30, 2011	Fiscal Year Ending June 30, 2010	Change	%
PROGRAM REVENUES:				
Charges for services	\$ 678,503	\$ 884,518	\$ (206,015)	(23%)
Operating grants and contributions	4,903,729	6,238,240	(1,334,511)	(21%)
Total program revenues	5,582,232	7,122,758	(1,540,526)	(22%)
GENERAL REVENUES:				
Investment income	187,453	66,364	121,089	182%
Total revenues	5,769,685	7,189,122	(1,419,437)	(20%)

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

	CONDENSED Statement of Activities			
	<i>Fiscal Year Ending June 30, 2011</i>	<i>Fiscal Year Ending June 30, 2010</i>	<i>Change</i>	<i>%</i>
EXPENSES:				
Payroll and related costs	2,355,835	2,462,210	(106,375)	(4%)
Other expenses	3,739,943	3,106,717	633,226	20%
Depreciation	503,373	446,666	56,707	13%
<i>Total expenses</i>	6,599,151	6,015,593	583,558	10%
Increase (decrease) in net assets	\$ (829,466)	\$1,173,529	\$(2,002,995)	-

The 2010-2011 revenues decreased by \$1,419,437 when compared with last fiscal year, mainly due to a decrease in operating grants and contributions. Total program expenses increased by \$583,558 mainly due to the increase of \$455,022 in payroll and related costs due to Act. 70 regulation effect, and an increase in certain general and administrative expenses, such as professional services.

Although fiscal emergency Law 7 accounted for a decrease in payroll and related costs of \$561,397, Act 70 regulations effect offset this decrease by \$455,022 as explained in Note 6.

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

FINANCIAL ANALYSIS OF THE SCHOOL'S FUNDS

A comparative analysis of overall fund financial activities is presented below:

	June 30,			
	2011	2010	Change	%
ASSETS				
Cash	\$ 617,843	\$1,359,085	\$ (741,242)	(55%)
Account receivable tuition fee	965,134	1,361,416	(396,282)	(29%)
Due from other funds	817,527	912,574	(95,047)	(10%)
Restricted investment	1,312,584	905,165	407,419	45%
	<u>3,713,088</u>	<u>4,538,240</u>	<u>(825,152)</u>	<u>(18%)</u>
LIABILITIES				
Account payable	403,964	682,460	(278,496)	(41%)
Due to other funds	817,527	912,574	(95,047)	(10%)
	<u>1,221,491</u>	<u>1,595,034</u>	<u>(373,543)</u>	<u>(23%)</u>
REVENUES				
Legislative appropriations	1,824,000	2,650,759	(826,759)	(31%)
Federal grants	3,079,729	3,587,481	(507,752)	(14%)
Investments income	187,453	66,364	121,089	182%
Tuition fees and other	678,503	884,518	(206,015)	(23%)
	<u>5,769,685</u>	<u>7,189,122</u>	<u>(1,419,437)</u>	<u>(20%)</u>
EXPENDITURES				
Payroll and related costs	1,955,738	2,462,210	(506,472)	(21%)
Payments for public services	328,671	341,291	(12,620)	(4%)

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

	June 30,			
	2011	2010	Change	%
Professional services	1,414,493	1,370,941	43,552	3%
Insurance expenses	89,127	89,109	18	0%
Other expenses	1,907,652	1,305,376	602,276	46%
Capital outlay	587,654	274,598	313,056	114%
	<u>\$6,283,335</u>	<u>\$5,843,525</u>	<u>\$439,810</u>	<u>8%</u>

The School's governmental funds showed a decrease in assets of \$825,152, due to an decrease in cash and accounts receivable despite an increase in investments during the current year. At the same time revenues from legislature increase by \$826,759 while federal grants decrease by \$507,752 specifically due to ARRA funds not received for this year. Total expenditures increased by \$439,810 mainly due to a increase in capital outlay and other expenses while payroll showed an decrease compared with prior year.

General Fund Budgetary Highlights:

The 2010-2011 General Fund final expenditures budget was \$3,976,000, or \$92,090 under the actual spending of \$4,060,090. The difference was due to changes in expenditures such as expenses related to contracted and professional services. The budgeted revenues exceed by \$1,473,497 the actual revenues, due to that estimated tuition fees were over the actual. The results showed revenues in excess of expenditures by \$1,565,587.

Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year 2010-2011, the School had invested \$8,292,654, net of accumulated depreciation, in a broad range of capital assets (*See table below*). Depreciation charged for this fiscal year totaled \$503,373.

Capital Assets as of June 30, 2011

	Cost	Accumulated Depreciation	Net Assets
Buildings	\$ 7,000,000	\$ 1,102,500	\$5,897,500
Buildings improvements	2,597,935	668,376	1,929,559
Furniture and fixtures	673,566	535,772	137,794
Other equipment	877,167	647,153	230,014
Computers	925,451	843,023	82,428
Software	267,956	252,597	15,359
Motor vehicles	37,294	37,294	-
Total	\$12,379,369	\$4,086,715	\$8,292,654

Compensated Absences

At the end of the fiscal year 2010-2011, the School had a debt to cover future commitments for vacation and sick leave amounting of \$548,672 or 27% less than prior year.

***Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis***

Economic Outlook

Prior to year 2009-2010, the School obtained a Restoration of Building grant through the Municipality of San Juan, to be used to make improvements in the School's principal building. As of June 30, 2011 the municipality due \$378,164 from this grant, which was collected by the School after this date.

During the prior year the School was authorized to receive \$798,000 from the State Fiscal Stabilization Fund (SFSF) under the Education State Grant Recovery Act. Of this amount the School received \$248,028 which was used for payroll and related expenses during prior year, and the rest was used during this year for the same purposes.

Legislative appropriations of Joint Resolution decrease by \$615,000. However, legislature appropriates from the Fiscal Stabilization Fund amounted to \$1,450,000. Also for the year ended June 30, 2011, the School received federal grants for \$2,555,613 of \$1,101,554 represents reimbursements to students and is showed as other expense in the special revenue fund. Therefore, the net amount available for the School operations was \$1,454,059. Mainly these funds were used to pay for professional services recorded as expense in the general fund.

The School is not aware of any other currently known facts, decisions, or conditions that are expected to have a significant effect on the financial position or results of operations during the next fiscal year (2010-2011).

Contacting The School's Office of Financial Management

This report is designed to provide a general overview of the School's finances and to demonstrate the School's accountability for the money it receives. If you have any questions about this report or need additional information, contact the School's Administration Office at (787) 725-8120.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2011

ASSETS

Cash	\$ 617,843
Accounts Receivable - Tuition fees and other, net	965,134
Restricted investments	1,312,584
Capital assets, net of accumulated depreciation	<u>8,292,654</u>
<i>Total assets</i>	<u><u>\$11,188,215</u></u>

LIABILITIES

Accounts payable	\$ 804,061
Compensated absences:	
Expected to be paid within one year	60,353
Expected to be paid after one year	<u>488,319</u>
<i>Total liabilities</i>	<u>1,352,733</u>

NET ASSETS

Invested in capital assets	8,292,654
Restricted for:	
Student aid	1,312,584
Unrestricted	<u>230,244</u>
<i>Total net assets</i>	<u><u>\$ 9,835,482</u></u>

*See independent auditor's report
and accompanying notes to the
basic financial statements.*

ESCUELA DE ARTES PLASTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

EXPENSES:

Education:

General and administrative:

Payroll and related costs \$2,355,835

Payments for public services 328,671

Professional services 1,414,493

Insurance expense 89,127

Other expenses 1,907,652

Depreciation 503,373

Total Program expenses 6,599,151

PROGRAM REVENUES:

Charges for services 678,503

Operating grants and contributions 4,903,729

Investment income 187,453

Total program revenues 5,769,685

Change in net assets (829,466)

NET ASSETS AS OF JUNE 30, 2010, as restated 10,664,948

NET ASSETS AS OF JUNE 30, 2011 \$ 9,835,482

*See independent auditor's report
and accompanying notes to the
basic financial statements.*

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
BALANCE SHEET - GOVERNMENTAL FUNDS
JUNE 30, 2011

	<i>General Fund</i>	<i>Special Revenue Fund</i>	<i>Capital Projects Fund</i>	<i>Total Governmental Funds</i>
ASSETS				
Cash in banks	\$ 174,224	\$ 443,619	\$ -	\$ 617,843
Account Receivable	215,432	371,538	378,164	965,134
Due from other funds	731,575	85,952	-	817,527
Restricted investment	321,427	991,157	-	1,312,584
<i>Total assets</i>	<u>\$1,442,658</u>	<u>\$1,892,266</u>	<u>\$378,164</u>	<u>\$3,713,088</u>
LIABILITIES				
Accounts payable	\$ 353,537	\$ 50,427	\$ -	\$ 403,964
Due to other funds	85,952	328,182	403,393	817,527
<i>Total Liabilities</i>	<u>\$ 439,489</u>	<u>\$ 378,609</u>	<u>\$403,393</u>	<u>\$1,221,491</u>
FUND BALANCES				
Nonspendable	-	-	-	-
Restricted		1,513,657		1,513,657
Committed	11,163			11,163
Assigned	400,000			400,000
Unassigned	592,006	-	(25,229)	566,777
Total fund balances	<u>1,003,169</u>	<u>1,513,657</u>	<u>(25,229)</u>	<u>2,491,597</u>
Total liabilities and fund balances	<u>\$1,442,658</u>	<u>\$1,892,266</u>	<u>\$378,164</u>	

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	\$ 8,292,654
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See independent auditor's report and accompanying notes to the basic financial statements.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
BALANCE SHEET - GOVERNMENTAL FUNDS (CONT.)
JUNE 30, 2011

	<i>Total Governmental Funds</i>
Compensated absences and early retirement benefits funds are not due and payable in the current period and therefore are not reported in the funds.	<u>(948,769)</u>
Net assets of governmental activities	<u><u>\$ 9,835,482</u></u>

*See independent auditor's report
and accompanying notes to the
basic financial statements.*

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

	<i>General Fund</i>	<i>Special Revenue Fund</i>	<i>Capital Projects Fund</i>	<i>Total Governmental Funds</i>
REVENUES:				
Legislative appropriations	\$1,824,000			\$1,824,000
Federal grants	-	3,079,729		3,079,729
Investment income	-	187,453		187,453
Tuition fees and other	678,503	-		678,503
<i>Total revenues</i>	<u>\$2,502,503</u>	<u>3,267,182</u>		<u>5,769,685</u>
EXPENDITURES:				
Education:				
General and administrative:				
Payroll and related costs	1,346,097	609,641		1,955,738
Payments for public services	328,671	-		328,671
Professional services	1,358,126	56,367		1,414,493
Insurance expense	89,127	-		89,127
Other expenses	851,246	1,056,406		1,907,652
Capital outlay	83,660	125,830	378,164	587,654
<i>Total expenditures</i>	<u>4,056,927</u>	<u>1,848,244</u>	<u>378,164</u>	<u>6,283,335</u>
Excess of revenues over (under)	<u>(1,554,424)</u>	<u>1,418,938</u>	<u>(378,164)</u>	<u>(513,650)</u>
FUND BALANCES AS OF JUNE 30, 2010	(1,525,600)	4,518,606	(49,801)	2,943,205
Prior period adjustments	4,083,193	(4,423,887)	402,736	62,042
Fund balances June 30, 2010, as restated	2,557,593	94,719	352,935	3,005,247
FUND BALANCES AS OF JUNE 30, 2011	<u><u>\$(1,003,169)</u></u>	<u><u>\$1,513,657</u></u>	<u><u>\$(25,229)</u></u>	<u><u>\$2,491,597</u></u>

*See independent auditor's report
and accompanying notes to the
basic financial statements.*

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES
AND CHANGES IN FUND BALANCES GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

NET CHANGE IN FUND BALANCES - Total governmental funds \$ (513,650)

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. This is the amount by which capital outlays exceeds depreciation in the current period.	84,281
Effect of early retirement benefits on the statement of activities	<u>(400,097)</u>
Change in net assets of governmental activities	<u><u>\$(829,466)</u></u>

*See independent auditor's report
and accompanying notes to the
basic financial statements.*

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Escuela de Artes Plásticas de Puerto Rico (the School), is a component unit of the Commonwealth of Puerto Rico. Law No. 52 of June 21, 1971 (as amended) created the School. Through Law No. 54 of August 22, 1990, the School acquired its autonomy, which gave it the right to determine its purpose, powers and functions separate from the Institute of Culture of Puerto Rico. The School was created to develop, promote, plan and coordinate programs of study in higher education oriented to the plastic arts, teaching artistic techniques and to help students to develop humanistic values.

The School's financial statements are prepared in accordance with generally accepted accounting principles (GAAP). GAAP includes all relevant Governmental Accounting Standards Board (GASB) pronouncements. In the government-wide financial statements and the funds financial statements, Financial Accounting Standard Board (FASB) Pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, have been applied unless those pronouncements conflict with or contradict GASB pronouncements, in which case, GASB prevails. The accounting and reporting framework and more significant accounting are discussed in subsequent subsections of this note.

FINANCIAL REPORTING ENTITY

The School's financial reporting entity comprises all significant activities on which the School exercises oversight responsibility. There are not blended component units. The School complies with the provisions of Governmental Accounting Standards Board Statement No. 14, "The Financial Reporting Entity".

BASIS OF PRESENTATION

Government-wide Financial Statements:

The government-wide financial statements include the statement of net assets and statement of activities. These statements report financial information for the School as whole excluding fiduciary activities. The statements distinguish between governmental and business-type activities. There are no business-type activities at the School. Governmental activities generally are financed through intergovernmental revenues, state and federal grants.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

In the government-wide Statement of Net Assets, both the governmental and business-type activities columns (a) are presented on a consolidated basis by columns, (b) are on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations (c) internal activity is eliminated. The school's net assets are reported in three parts-invested in capital assets, net of related debt, restricted net assets, and unrestricted net assets. The school first utilizes restricted resources to finance qualifying activities.

The government-wide Statement of Activities reports both the gross and net cost of each of the School's functions and activities. The functions are also supported by general government revenues. The Statement of Activities reduces gross expenses (including depreciation) by related programs revenues, operating and capital grants. Program revenues must be directly associated with the function or activity. The net cost (by function activity) are normally covered by general revenue.

The school does not allocated indirect costs. An administrative service fee is charged by the General Fund to the other operating funds that is eliminated like a reimbursement (reducing the revenue and expenses in the General Fund) to recover the direct costs of General Fund services provided (finance, personnel, purchasing, legal technology management, etc.)

This government-wide focus is more on the sustain ability of the school as an equity and the change in the school's resulting from the current year's activities.

Fund Financial Statements

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be separate accounting entities. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into two major categories: governmental and fiduciary. An emphasis is placed on major funds within the governmental category. A fund is considered major using if it is the primary operating fund (the general fund) or meets the following criteria:

- a. Total assets, liabilities, revenues or expenditures/expenses of that individual fund are at least 10% of the corresponding total for all funds of that category or type; and,

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

- b. Total assets, liabilities, revenues or expenditures/expenses of the individual fund are at least 5% of the corresponding total for all governmental funds combined.

The funds of the School are described below:

Governmental Funds

General Fund

The General Fund is the primary operating fund of the School and always classified as a major fund. It is used to account for all activities except those required legally or administratively to be accounted for in other funds. This fund is primarily financed through appropriations from the Legislature of the Commonwealth of Puerto Rico, federal grants, and tuition fees paid by the students.

Special Revenue Fund

Special Revenue Funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for certain purposes. Revenue sources are derived from federal and state grants restricted. The School administers the following Special Revenue Funds:

- Title IV-US Department of Education
- Title V-US Department of Education
- Restricted donation from private sectors for specific purposes
- State Fiscal Stabilization Fund

Capital Project Fund

The Capital Project Fund is used to account for resources restricted for the acquisition or construction of specific capital projects or items. The School has one capital project fund and is used to account for the restoration and improvement of its buildings. Revenues are derived from State Government legislative resolutions.

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Major and Non-major Funds

<u>Fund</u>	<u>Description</u>
<i>Major:</i>	
<i>General Fund</i>	See above for description
<i>Special Revenue Fund</i>	Title V-Strengthening Institution-Hispanic Serving Institution Title IV - Federal Pell Grant Program
<i>Capital Project Funds</i>	Legislature Appropriation for Restoration of School building
<i>Other funds:</i>	Supplemental Opportunity Grant (SEOG), Federal Work Study Program (FWSP)

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe which transactions are recorded within the various financial statements. Basis of accounting refers to "when" transactions are recorded regardless of the measurement applied.

Measurement Focus

On the government-wide Statement of Net Assets and Statement of Activities, both governmental and business-like activities are presented using the economic resources measurement focus as defined below. In the fund financial statements, the "current financial resources" measurement focus or the "economic resources" measurement focus is used as appropriate:

- a. All governmental funds utilize a "current financial resources" measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of te period.

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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus (Cont.)

- b. Agency Funds are not involved in the measurement of results of operations; therefore measurement focus is not applicable to them.

Basis of Accounting

In the government-wide Statement of Net Assets and Statement of Activities, both governmental and business -like activities are presented using the accrual method of accounting. Under this method, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under this method, revenues are recognized when "measurable and available". Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or soon enough thereafter to pay current liabilities. Expenditures, (including capital outlays) are recorded when the related fund is incurred.

ASSETS, LIABILITIES, AND EQUITY

Cash and Investment

For the purpose of the Statement of Net Assets "cash" includes all demand, savings accounts and certificates of deposits of the School. Cash is maintained mainly in a pooled account with the fiduciary entity, the Government Development Bank of Puerto Rico (GDB). Each fund's portion of the pool is displayed on its respective balance sheet as Cash with fiduciary agent. The School considers highly liquid investment (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents. Federal deposit insurance corporation provide protection of School's cash as well as qualified pledged or pooled securities holding the assets. The institutions as well as the cash maintained at the GDB holds such collateral.

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NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ASSETS, LIABILITIES, AND EQUITY (CONT.)

Cash and Investment (Cont.)

Investments are reported at fair value, which is determined using selected bases. Short-term investments are reported at cost, which approximate fair value. Securities traded on a national exchange are valued at their last reported sales price or current exchange rates. School investments are maintained with a private brokerage firm in an endowment fund invested approximately 69% in stocks and options, and 31% invested in mutual funds and cash and sweep balances. Assets are held at broker's house, which carries their account and acts as their custodian for funds and securities deposited with them.

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that, in an event of a bank failure, the school's deposit might not be recovered. The Commonwealth requires that public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the GDB of the Commonwealth. The Company is discretely presented component unit of the Commonwealth of Puerto Rico.

Custodial Credit Risk for Investments

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the primary government may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2011 securities investments were unregistered and uninsured held by the counterparty's trust department or agent in the School's name.

Investment Income

Investment income, which includes changes in the fair value of the investment, is administratively assigned to the Special Revenue Fund.

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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ASSETS, LIABILITIES, AND EQUITY (CONT.)

Interfund Receivables and Payables

During the course of operations, numerous transactions occur between individual funds that may result in amounts owed between funds. Those related to goods and services type transactions are classified as "due to and from other funds". Interfund loans are reported as "inter-fund receivables and payables". Inter-fund receivables and payables between funds within governmental activities are eliminated in the Statement of Net Assets.

Fixed Assets

The accounting treatment over property and equipment (fixed assets) depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements.

Government-wide Statements

In the government-wide financial statements, fixed assets are accounted for as capital assets. All fixed assets are valued at historical cost or estimated historical cost if actual is unavailable, except for donated assets, which are recorded at their estimated fair value at the date of the donation.

Depreciation of all exhaustible fixed assets is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net Assets. Depreciation is provided over the asset's estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of assets is as follows:

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NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

ASSETS, LIABILITIES, AND EQUITY (CONT.)

Fixed Assets (Cont.)

Building	40 years
Building improvements	20 years
Furniture and fixtures	10 years
Other equipments	5 years
Computers	4 years
Software	2 years
Motor vehicles	5 years

Restricted assets

Restricted assets include cash maintained in an account for the restoration of the building, and investments in trust accounts that are legally restricted as to their use for special grants or purpose.

Compensated Absences

The School policies regarding vacation time permit employees to accumulate earned but unused vacation leave. The liability for these compensated absences is recorded in the government-wide statements. The current portion of this debt is estimated based on historical trends. In the fund financial statements, governmental funds report only compensated absence liability payable from expendable available financial resources.

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NOTES TO BASIC FINANCIAL STATEMENTS
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NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Equity Classification

Government-wide Statements

Equity is classified as net assets and displayed in three components:

- a. Invested in capital assets - Consists of capital assets including restricted capital assets, net of accumulated depreciation.
- b. Restricted net assets - Consists of net assets with constraints placed on the use either by (1) external groups such as grantors, or laws or regulations of other governments; or (b) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets - All other net assets that do not meet the definition of "restricted" or invested in capital assets.

Fund Statements

Governmental fund equity is classified as fund balance. Fund balance is further classified as reserved and unreserved, with unreserved further split between designated and undesignated.

REVENUES, EXPENDITURES AND EXPENSES

Operating revenues and expenses for government-wide financial statement are classified by function or activity for governmental activities.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, as applicable to governmental units, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

RECENTLY ISSUED ACCOUNTING STANDARDS

The Government Accounting Standard Board has issued GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits other Than Pensions*, which is effective for periods beginning after December 15, 2006, December 15, 2007 or December 15, 2009, depending on the level of total annual revenues; GASB Statement No. 47, *Accounting for Termination Benefits*, which is effective in two parts: for termination benefits provided through an existing defined benefit other post employment benefits plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45; for all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005. GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues*, which is effective for fiscal years beginning after December 15, 2006; GASB Statement No. 49, *Pollution Remediation Obligations*, and GASB Statement No. 50 - *Pension Disclosure* which is effective for fiscal years beginning after December 15, 2007; GASB Statement No. 52 - *Accounting and Financial Reporting for Intangible Assets* which is effective for fiscal year beginning after June 15, 2009; GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for fiscal years beginning after June 15, 2009. GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, effective for periods beginning after June 15, 2008; GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for periods beginning after June 15, 2009. The provisions of these statements did not affect the accompanying financial statements.

ACCOUNTING FOR THE IMPAIRMENT OR CAPITAL ASSETS

The Company accounts for asset impairment under the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This statement also establishes accounting requirements for insurance recoveries. A capital asset generally should be considered impaired if both (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstance is outside the normal life cycle of the capital asset. Impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. The provisions of this statement did not affect the accompanying financial statements.

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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 1- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FUND BALANCE REPORTING AND GOVERNMENTAL FUND TYPE DEFINITIONS

GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, will significantly change how this information is reported. The statement is intended to improve the usefulness of the amount reported in fund balance by providing more structured classification. The statement also clarifies the definition of existing governmental fund types and classify the fund balance in five categories, when apply: Nonspendable, Restricted, Committed, Assigned and Unassigned.

NOTE 2- STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

By its nature as a government unit, and as recipient of federal grants, the School is subject to various federal and local laws and regulations. An analysis of the School's compliance with significant laws and regulations and demonstration of its stewardship over School's resources follows:

FUND ACCOUNTING REQUIREMENT

The School complies with all local and federal funds laws and regulations requiring the use of separate funds. The legally required funds used by the School include the following:

<u>Fund</u>	<u>Required By</u>
Title V-US Department of Education	Grant Agreement
Capital Project Fund-Restoration of Building	Local Agreement
Title IV-Pell Grant	Grant Agreement
SEOP and FWS program	Grant Agreement
ACG/National SMART Program	Grant Agreement
Join Resolution	Local Agreement

DEPOSITS AND INVESTMENTS LAWS AND REGULATIONS

In accordance with federal law, all uninsured deposits in financial institutions with acceptable collateral valued at the lower of market or par. The government of the Commonwealth of Puerto Rico has placed collateral to secure uninsured bank accounts for all its agencies and local governments.

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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 2- STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (CONT.)

REVENUE RESTRICTIONS

The School has various restriction placed over certain revenue sources from local or federal requirements. The primary restricted revenue sources include:

- | | |
|--|--------------------------|
| • Title V-US Department of Education | Legal Restriction of Use |
| • Puerto Rico Council of Superior Education | Legal Restriction of Use |
| • Title IV-Pell Grant | Legal Restriction of Use |
| • Supplemental Educational Opportunity Program | Legal Restriction of Use |
| • Federal Work Study Program | Legal Restriction of Use |
| • ACG/National SMART Program | Legal Restriction of Use |
| • Capital Project-Restoration of Building | Legal Restriction of Use |
| • State Fiscal Stabilization Fund | Legal Restriction of Use |

For the year ended June 30, 2011, the School complied, in all material respects, with these revenue restrictions.

Also, for the year ended June 30, 2011, the School received federal grants for \$2,555,613 of which \$1,101,554 represents reimbursements to students and is showed as other expense in the special revenue fund. Therefore, the net amount available for the School operations was \$1,454,059.

NOTE 3 - CUSTODIAL RISK RELATED TO DEPOSITS AND INVESTMENTS

As of June 30, 2011, the Company's custodial credit risk was approximately \$704,324, which is the bank balance of the cash held by the Government Development Bank for Puerto Rico. These deposits are exempt from the collateral requirement established by the Commonwealth.

The School established an endowment fund to support their actual and future operations of the School. The objective of the fund is obtaining resources that can be invested and become a permanent source of income for the School. During the years 2010 and 2011, the School received a grant of \$499,100 and \$511,905, respectively from Title V (Hispanic Serving Institution Program) of the Federal Department of Education. Accordingly, these fund are subject to all rules and regulations of the Title V Endowment Regulations Code (Code of Federal Regulations, Parts 606), to the Endowment Challenge Grant Program (34 Code of Federal Regulations, Part 628 (as

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 3 - CUSTODIAL RISK RELATED TO DEPOSITS AND INVESTMENTS (CONT.)

amended) en the United State Code 1065. Other sources of income of the fund are donations from private parties, special fund raising campaigns and any other special assignments from federal or state governments.

The School established an investment guide for the purpose of defining and assigning responsibilities to all persons and entities involve in the process of control and invest the fund's resources. There is a special committee within the Board of Directors of the School with the responsibility to assure that management of the fund is consistent with the investment guide requirements. In addition, an external investment consultant, licensed by the Security an Exchange Commission, should be contracted to evaluate the investment portfolio regularly and determine if the investments have been made according to the rules established. The consultant must provide recommendations to the investment committee of any action necessary to accomplish the goals and objectives of the fund.

Following is detail information of the types and amount of the investments maintained by the School as of June 30, 2011:

Types of Investment	Fair Value/Carrying Amount	Cost
Mutual funds and cash and sweep balances	\$ 410,997	\$ 416,158
Stocks and options	901,587	784,285
	<u>\$1,312,584</u>	<u>\$1,200,443</u>

Investments are uninsured and unregistered held by the counterparty's trust department or agent in the school's name.

NOTE 4 - DETAIL ON TRANSACTIONS CLASSES/ACCOUNTS

The following notes presents detail information to support the amounts reported in the basic financial statements for its various assets, liabilities, equity, revenues, and expenditures/expenses.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 4 - DETAIL ON TRANSACTIONS CLASSES/ACCOUNTS (CONT.)

CAPITAL ASSETS

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

	<i>Balance at July 1, 2010</i>	<i>Additions</i>	<i>Retirements</i>	<i>Balance at June 30, 2011</i>
Buildings	\$7,000,000			\$7,000,000
Building Improvements	2,153,343	444,592		2,597,935
Furniture and fixtures	673,566			673,566
Other equipment	805,284	73,322	(1,439)	877,167
Computers	875,718	60,231	(10,498)	925,451
Software	258,447	9,509		267,956
Motor vehicles	37,294	-		37,294
<i>Total capital assets</i>	\$11,803,652	\$587,654	\$(11,937)	\$12,379,369

The accumulated depreciation is as follows:

	<i>Balance at July 1, 2010</i>	<i>Additions</i>	<i>Retirements</i>	<i>Balance at June 30, 2011</i>
Building	\$945,000	\$ 157,500		\$1,102,500
Building Improvements	566,240	102,136		668,376
Furniture and Fixture	493,431	42,341		535,772
Other equipment	564,564	84,028	(1,439)	647,153

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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011

NOTE 4 - DETAIL ON TRANSACTIONS CLASSES/ACCOUNTS (CONT.)

CAPITAL ASSETS (CONT.)

	<i>Balance at July 1, 2010</i>	<i>Additions</i>	<i>Retirements</i>	<i>Balance at June 30, 2011</i>
Computers	746,323	107,198	(10,498)	843,023
Software	242,427	10,170		252,597
Motor Vehicles	37,294	-		37,294
	<u>3,595,279</u>	<u>503,373</u>	<u>(11,937)</u>	<u>4,086,715</u>
	<u>\$8,208,373</u>	<u>\$ 84,281</u>	<u>\$ -</u>	<u>\$8,292,654</u>

COMPENSATED ABSENCES

As of June 30, 2011, the accrued compensated absences debt of the School consisted of following:

	Beginning of Year	Accrued	Expensed	Ending of Year
Vacations	\$181,291	\$43,430	\$ (100,409)	\$124,312
Vested sick leave	594,026	145,398	(295,064)	424,360
	<u>\$755,317</u>	<u>\$188,828</u>	<u>\$ (395,473)</u>	<u>\$548,672</u>

**ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 5 - RETIREMENT PLAN

The School is a participant in the employee's retirement system of the Government of Puerto Rico and instrumentalities (ERS), a multiple-employer contributory retirement plan, which covers substantially all government employees. The system provides retirement, death and disability benefits and annuities to employees not covered by other governmental agency retirement system.

Act No. 447, approved on May 15, 1951, as amended, determines retirement and related benefits and contributions to the system by employees. Monthly contributions to the ERS equal 8% of the participating employee's salary through March 31, 1990, and 9.27% thereafter.

For the year ended June 30, 2011, substantially all employees were covered under the above mentioned system. Covered payroll refers to all compensation paid by the School to active employees covered by the ERS on which contributions to the pension are based.

Members who have attained an age of at least fifty five years and have completed at least twenty five years of creditable service, or members who have completed at least eight years (sixty five years for employees becoming members after March 31, 1990), and have completed at least ten years of creditable service, are entitled to an annual benefit, payable monthly for life. Contributions for the year ended June 30, 2011 amounted to \$222,381.

NOTE 6 - 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 Escuela de Artes Plásticas de Puerto Rico 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 Escuela de Artes Plásticas de Puerto Rico 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 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

**ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
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NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 6 - VOLUNTARY TERMINATION BENEFITS (CONT.)

consist of a lump-sum payment ranging from one-month to six-month salary based on employment years. Additionally, eligible employees 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 Escuela de Artes Plásticas de Puerto Rico.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Escuela de Artes Plásticas de Puerto Rico financial statements of a liability of \$455,022 in the statement of net assets as of June 30, 2011 and a charge of \$455,022 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 15.15%.

NOTE 7 - CONTINGENCIES

In the normal course of operations, the School participates in various and local grants programs from year to year. The grant programs are often subject to additional audits by agents of the granting agency, the purpose of that is to ensure compliance with the specifics conditions of the grant. Any liability for reimbursement that may arise as a result of these audits cannot be reasonably determined at this time, although it is believe the amount, if any, would not be material.

The School is also subject to regular audits by the Government Office of The Comptroller of Puerto Rico. Based on audit reports received, the School does not have significant violation of laws that many have a material effect in the Financial Statements.

As of the date of the audit report, various lawsuits against the School for damage and prejudice were in process pending of additional hearings, some documents or information requested by the courts. Total amount claimed in these lawsuits remained undetermined. However, the School's lawyer believes that the cases are nuisance suits where damages claimed are clearly of proportion with the damages suffered by claimants, and ultimately settlements will be reaches for much smaller amounts, if any. In addition, the School as a component unit of government of the Commonwealth of Puerto Rico, is covered by contingency fund of the central government created for this purpose.

**ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2011**

NOTE 7 - CONTINGENCIES (CONT.)

As of the date of the audit report, several personnel claims against the School were in process in JASAP (Joint Administration of the Personnel System of the Commonwealth of Puerto Rico). These actions were basically for employment restitutions and do not involve monetary damages, or at least, damages if any, will be miscellaneous.

The School Management and their legal counsel believe that any resulting monetary damages from the lawsuits would be immaterial to the financial statements, and, such damages will be covered by the general contingency fund of the Commonwealth of Puerto Rico. Accordingly, financial statements do not include a reserve for the possible outcome of these cases.

NOTE 8 -PRIOR PERIOD ADJUSTMENTS

Below is reconciliation of the beginning fund balance as previously reported and the balances as restated:

Statement of Revenues, Expenditures and Changes in Fund Balance:

Fund balance as of June 30, 2010 as previously reported	\$2,943,205
Adjustments to correct inter fund balances, cash and other accounts	<u>62,042</u>
Fund balance as of June 30, 2010	<u><u>\$3,005,247</u></u>

Statement of Activities:

Net assets as of June 30, 2010 as previously reported	\$10,396,261
Adjustments to correct various accounts	<u>268,687</u>
Net assets as of June 30, 2010, as restated	<u><u>\$10,664,948</u></u>

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
BUDGET-TO-ACTUAL COMPARISON SCHEDULE
GENERAL FUND - UNAUDITED
FOR THE YEAR ENDED JUNE 30, 2011

	General Fund			
	Original Budget	Amended Budget	Actual	Variance Positive (Negative)
Revenue:				
Legislative appropriations	\$2,229,000	\$1,824,000	\$1 824,000	\$ -
Tuition fees and other	2,751,000	2,152,000	678,503	(1,473,497)
<i>Total revenues</i>	<u>4,980,000</u>	<u>3,976,000</u>	<u>2,502,503</u>	<u>(1,473,497)</u>
Expenditures:				
Payroll and related costs	\$2,315,000	\$1,541,000	\$1,346,097	\$ 194,903
Payments for public services	440,000	359,000	328,671	30,329
Professional services	1,287,000	1,313,000	1,358,126	(45,126)
Other expenses	938,000	763,000	1,035,196	(272,196)
<i>Total expenditures</i>	<u>4,980,000</u>	<u>3,976,000</u>	<u>4,068,090</u>	<u>(92,090)</u>
Excess of revenues (under) over expenditures	<u>-</u>	<u>-</u>	<u>\$(1,565,587)</u>	<u>\$(1,565,587)</u>

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
ON BUDGETARY ACCOUNTING AND CONTROL
FOR THE YEAR ENDED JUNE 30, 2011

BUDGETARY ACCOUNTING AND CONTROL

Budget Law

The School prepares its annual operating budget under the provision of the Budget and Management Office of the Commonwealth of Puerto Rico. In accordance with those provisions, the following process is used to adopt the annual budget.

- a. School's department managers submit its budget to the chancellor according to their projected goals and objectives.
- b. After a carefully evaluation of the individual department budgets and the result of operation of the preceding year of the school, a final budget is prepared with a recommendation to the Board of Directors.
- c. The Board of Directors evaluates the proposed budget and gives its approval or demands any necessary adjustment.
- d. After the Board of Directors finally approves the budget is submitted to the Budget and Management Office for its approval. In this stage the School management has to defend it according to their necessities, projections, goals and objectives.
- e. Once approved or modified by the Budget and Management Office, it is submitted with a recommendation to the Governor of the Commonwealth of Puerto Rico.
- f. According to the available funds certified by the Treasury Department of Puerto Rico in term of the general fund estimates and the Governmental Development Bank and their credit margin, a final recommendation is grouped in the Government Annual Budget of Operating Expenses and Permanent Improvements that Governor presents to the Puerto Rico Legislature. This process takes places between January to March every year.
- g. Public hearings are conducted at regular Legislature meetings to obtain comments about the work plans and projections of every state department or office.
- h. Subsequent to the public hearings, but no later than July 1, the Puerto Rico Legislature legally enacts the budget through the passage of a resolution.

**ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
ON BUDGETARY ACCOUNTING AND CONTROL (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2011**

Budgetary Accounting

The annual operating budgets of governmental funds are prepared and presented on the modified accrual basis of accounting.

Encumbrances outstanding at year end represent the estimated amount of the expenditures ultimately to result if unperformed contracts (i.e., purchase orders, other commitments) in process are completed. Encumbrances are reported as reservations of fund balances in the GAAP governmental funds statements since they do not constitute expenditures or liabilities but do commit appropriations. Encumbrances are carried forward and added to the subsequent year's appropriations. The unencumbered balance of each appropriation lapses at year-end and revert to the respective fund which it was appropriated and becomes available for future appropriation.

The principal differences between the GAAP and budgetary basis and the necessary adjustments to convert the results of operations of the general fund from the GAAP basis of accounting to the budgetary basis of accounting are as follows:

	<i>For the year ended June 30, 2011</i>
Excess of revenues over expenditures revenues per Statement of Revenues, Expenditures, and Changes in Fund Balance; accounting basis	\$(1,554,424)
Current year encumbrances of annually budgeted funds recognized as expenditures on the budgetary basis	<u>(11,163)</u>
Excess of expenditures over revenues per Statement of Revenues, and Expenditures -Budget and Actual; budgetary basis	<u><u>\$(1,565,587)</u></u>

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2011

Federal Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	Amount
US DEPARTMENT OF EDUCATION		
Direct Programs:		
Federal Pell Grant Program	84.063	\$2,470,535
Federal Supplemental Education Opportunity Grant Program	84.007	16,266
Federal Work-Study Program	84.033	21,512
ACG/National SMART Grant Program	84.375 84.376	47,200
Title V Developing Hispanic Serving Institutions Program	84.031S	412,601
State Fiscal Stabilization Fund (SFSF) - Education State Grants Recovery Act	84.394	<u>530,633</u>
TOTAL EXPENDITURES OF FEDERAL AWARDS		<u><u>\$3,498,747</u></u>

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
PROGRAMS
FOR THE YEAR ENDED JUNE 30, 2011

1. General

The accompanying Schedule of Expenditures of Federal Awards Program presents the expenditures of the federal programs administered by the Escuela de Artes Plásticas de Puerto Rico.

2. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards Programs is presented using accrual basis of accounting.

3. Relationship to Financial Statements

Federal financial assistance revenues are reported in the School's Statement of Revenues, Expenditures and Changes in Fund Balances as Federal grants for students and Federal Grant Title V. The reconciliation of expenses in the Schedule of Expenditures of Federal Awards Programs to the financial statements follows:

Expenditures per financial statements	\$1,848,244
Plus:	
Other expenditures	<u>1,650,503</u>
Expenditures per Schedule of Federal Awards Programs	<u><u>\$3,498,747</u></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**

*Escuela de Artes Plásticas de Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico*

We have audited the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Escuela de Artes Plásticas de Puerto Rico (the School) (a component unit of the Commonwealth of Puerto Rico) as of and for the year ended June 30, 2011 which collectively compromise the School's basic financial statements and have issued our report thereon dated November 14, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the School's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the of the School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School'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 misstatements on a timely basis. A material weakness is a significant deficiency, or combination of deficiencies, 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 would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material

*Escuela de Artes Plásticas de Puerto Rico
(A component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico*

**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**

Internal Control over Financial Reporting (Cont.)

weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting described in the accompanying schedule of questioned costs that we consider to be significant deficiencies in internal control over financial reporting. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School's basic financial statements are free of material misstatement, we performed test of its compliance with certain provision of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect in 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 opinion. The results of our test disclosed no instances of noncompliance or other matters that is required to be reported under Government Auditing Standards.

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

Rodríguez & Espada, CPA, PSC

November 14, 2011
The CPA stamp number 2620300
was affixed to the original of this report.

**Report on Compliance With Requirements That Could Have a Direct
and Material Effect on Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133**

*Escuela de Artes Plásticas de Puerto Rico
(A Component Unit Of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico*

Compliance

We have audited the compliance of the Escuela de Artes Plásticas de Puerto Rico (the School) (a Component unit of the Commonwealth of Puerto Rico) with the types of compliance requirements described in the OMB Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2011. The School'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 School's management. Our responsibility is to express an opinion on the School'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 a 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 School'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 School's compliance with those requirements.

In our opinion, the Escuela de Artes Plásticas de Puerto Rico complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2011.

**Report on Compliance With Requirements That Could Have a Direct
and Material Effect on Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133**

*Escuela de Artes Plásticas de Puerto Rico
(A Component Unit Of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico*

Internal Control Over Compliance

Management of the School 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 School's internal control over compliance with the requirements that could have a direct and material effect on mayor federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test a report on internal control over compliance in accordance with OMB Circular 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 School's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness* is a significant deficiency, or combination of deficiencies, 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 the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

**Report on Compliance With Requirements That Could Have a Direct
and Material Effect on Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133**

*Escuela de Artes Plásticas de Puerto Rico
(A Component Unit Of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico*

Internal Control Over Compliance (Cont.)

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

Rodríguez & Espada, CPA, PSC

November 14, 2011
The CPA stamp number 2620301
was affixed to the original of this report.

**ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
 (A Component Unit of the Commonwealth of Puerto Rico)
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 FOR THE YEAR ENDED JUNE 30, 2011**

Section I- Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unqualified
Internal control over financial reporting:	
• Material weaknesses identified.	No
• Significant deficiency that are not considered to be a material weakness.	Yes
Noncompliance material to financial statements noted.	No

Federal Awards Programs

Type of auditor's report issued on compliance for major programs:	
Internal control over major programs:	
• Material weaknesses identified.	No
• Significant deficiencies that are not considered to be a material weakness.	No
Type of auditor's report issued on compliance for major programs.	Unqualified
Any audit findings disclosed that are required to be reported in accordance with Section 510 (a) of Circular A-133.	No

Identification of major programs:

<u>CFDA Number</u>	<u>Name of Federal Program</u>
84.063	Federal Pell Grant
84.007	Federal Supplemental Education Opportunity Grant Program
84.033	Federal Work-Study Program
84.031S	Title V-Developing Hispanic Serving Institution Program
Dollar threshold used to distinguish between Type A and B programs:	\$300,000
Auditee qualified as low-risk auditee?	Yes

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2011

Section II - Financial Statements Audit Findings

Category

Internal Control Over Financial Reporting

Segregation of duties

Condition

The same employee is in charge of multiple functions in the accounting department. He is the property manager, but also has functions of bookkeeping and collection of funds.

This situation was disclosed in prior year's audit.

Criteria

Segregation of duties means that no single individual should have control over two or more phases of transaction or operation. The function of authorization, custody, record-keeping and reconciliation should be segregated to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of the operation.

Cause

Lack of personnel in the Finance Department is the principal reason for this situation.

Effect

As consequence we noted that such employee is not fully complying with his functions, specifically in the safeguarding of assets tasks. We found errors in the property number of various items and property not found where it belongs. Also we noted that no property ledger is maintained by him.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
Schedule of Findings and Questioned Costs
For the Year Ended June 30, 2011

Section II - Federal Awards Audit Findings

NONE

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
Schedule of Findings and Questioned Costs and
Disposition from prior years
For the Year Ended June 30, 2011

Section III - Federal Awards Audit Findings - Questioned Costs

Finding Number 10-02

Catalog Number

CFDA #84.063

Program Title

Federal Pell Grant Program

Category

Compliance/Internal Control over Compliance

Compliance Requirement

GAPS and Cash Management

Criteria

The GAPS and Cash Management criteria is meant to ensure that when the institution draws down funds, cash on hand does not exceed the immediate disbursements needs for the SFA programs, three working days as established by 34 CFR 668.166. The three working days start on the date the drawdown is entered into GAPS.

Condition

During our GAPS and Cash Management test, we found that in one instance, the SFA funds were disbursed after the three working days period.

Cause

There is no adequate internal controls over the process to determine that funds were disbursed on time.

ESCUELA DE ARTES PLÁSTICAS DE PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
Schedule of Findings and Questioned Costs and
Disposition from prior years
For the Year Ended June 30, 2011

Section III - Federal Awards Audit Findings - Questioned Costs (Cont.)

Effect

As consequence the institution may not comply with the three working day criteria and have excess of cash tolerance.

Questioned Costs

None

Recommendation

Management should create control procedures to ensure that funds are disbursed no later three business days following the date institution received the funds.

Management Response

See Correction Action Plan