guzmán torres castro & díaz., psc
certified public accountants & business advisors

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

AUDITED FINANCIAL STATEMENTS AND
SINGLE AUDIT OF FEDERAL FINANCIAL
ASSISTANCE PROGRAM
FOR THE YEAR ENDED JUNE 30, 2012
TOGETHER WITH INDEPENDENT AUDITORS' REPORTS

400 Américo Miranda Ave.
Cosvi Building 3rd Floor
San Juan, PR 00926
787.622.0029
787.622.0049
www.guzmantorres.com

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A component Unit of the Commonwealth of Puerto Rico)

TABLE OF CONTENTS

	Page(s)
Independent Auditors' Report	1-3
Managements' Discussion and Analysis	4-11
Financial Statements:	
Statements of Net Assets	12
Statements of Revenues, Expenses and Changes in Net Assets	13
Statements of Cash Flows	14-15
Notes to Financial Statements	16-30
Schedule of Expenditures of Federal Awards:	
Schedule of Expenditures of Federal Awards	31
Notes to Schedule of Expenditures of Federal Awards	32
Report of Independent Auditors on Compliance and Internal Control over Financial Reporting in Accordance with Government Auditing Standards	33-34
Report of Independent Auditors on compliance with requirements applicable to each Major Program and on Internal Control over Compliance in accordance with OMB Circular A-133	35-36
Schedule of Findings and Questioned Costs	37-46
Summary of Schedule of Prior Year Audit Findings	47-50

gt&d | guzmán torres castro & díaz., psc
certified public accountants & business advisors

INDEPENDENT AUDITORS' REPORT

Hon. Rubén A. Hernández Gregorat, MEM, P.E.
Secretary Department of Transportation and Public Works

We have audited the accompanying statements of net assets of the Puerto Rico and Municipal Islands Maritime Transport Authority (the Authority), a component unit of the Commonwealth of Puerto Rico as of June 30, 2012 and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraphs, we conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audit contained in *Government Auditing Standards,* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

The Authority has been unable to determine the cost of the parts inventory that should be recorded in the financial statements.

The Authority did not provide an actuarial valuation report to record the liability and current year cost of the certain post-employment benefits described in Note 9 to the financial statements as required by accounting principles generally accepted in the United States of America ("GAAP"). The cost of these benefits are recorded in the financial statements when paid which is a method not accepted by GAAP.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the Authority being able to determine the cost of the parts inventory that should be recorded in the financial statements and had we been able to obtain an actuarial report to record the cost and the liability of the post-employment benefits as required by GAAP as described in the preceding paragraphs, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico and Municipal Islands Maritime Transport Authority at June 30, 2012 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

400 Américo Miranda Ave.
Cosvi Building 3rd Floor
San Juan, PR 00926

787.622.0029
787.622.0049
www.guzmantorres.com

As described in Note 12 to the financial statements, the Authority received operating assistance from the Commonwealth of Puerto Rico to assist in the financing of the Authority's operations. The amount of such assistance indicates that the Authority may require continued assistance in order to operate at its current level.

In accordance with *Government Auditing Standards*, we have also issued our report, dated October 1, 2012, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering 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 11 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 Authority's basic financial statements. The 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 is the responsibility of Authority's management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Guzmán, Torres Castro & Díaz, CPA's PSC
Certified Public Accountants
October 1, 2012

Stamp # 2667358 was affixed
to the original of this report.

(Unaudited)

The following discussion and analysis of the financial performance and activity of the Puerto Rico and Municipal Islands Maritime Transport Authority ("the Authority") provides an introduction and understanding of the basic financial statements of the Authority for the fiscal year ended June 30, 2012. This discussion was prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Financial Highlights for 2012

- Net assets deficiency totaled $10.7 million at June 30, 2012.
- Net assets deficiency decreased by $2.5 million in 2012, as compared to a decrease in of approximately $18.4 million in 2011.
- Net capital assets totaled $60.3 million at June 30, 2012.
- Net capital assets increased by 13.84% at June 30, 2012, when compared with the balance at June 30, 2011 of $52.9 million.

Financial Highlights for 2011

- Net assets deficiency totaled $8.1 million at June 30, 2011.
- Net assets deficiency decreased by $18.4 million in 2011, as compared to a decrease in of approximately $3.0 million in 2010.
- Net capital assets totaled $52.9 million at June 30, 2011.
- Net capital assets increased by 19.5% at June 30, 2011, when compared with the balance at June 30, 2010 of $44.3 million.

The Financial Statements

The basic financial statements provide information about the Authority's business-type activities. The financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB).

Overview of the Financial Statements for Business-Type Activities

The financial statements consist of the (1) statement of net assets, (2) statement of revenues, expenses, and changes in net assets, (3) statement of cash flows, and (4) notes to the financial statements. The financial statements are prepared on the accrual basis of accounting, meaning that all expenses are recorded when incurred and all revenues are recognized when earned, in accordance with accounting principles generally accepted in the United States of America.

Statement of Net Assets
The statement of net assets reports all financial and capital resources of the Authority. The statement is presented in the format where assets equal liabilities plus net assets. Assets and liabilities are presented in order of liquidity and are classified as current (convertible into cash within one year) and non-current. The focus of the statement of net asset is to show a picture of the liquidity and health of the Authority's financial position as of the end of the year.

The Authority's net assets are reported in the following categories:

- *Net Assets Invested in Capital Assets, Net of Related Debt* - this component of net assets consists of all capital assets, reduced by the outstanding balances of any bonds, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. Although the Authority's investment in its capital assets is reported net of related debt, it is noted that the resources required to repay this debt must be provided annually from operations and from the operating grant allocated annually by the Commonwealth of Puerto Rico, since the capital assets themselves cannot be used to liquidate liabilities.

- *Unrestricted Net Assets* - this component includes all net assets that do not meet the definition of net assets invested in capital assets.

Statement of Revenues, Expenses, and Changes in Net Assets
The statement of revenues, expenses, and changes in net assets includes operating revenues, which consist of passenger and cargo revenues and equipment and property rentals and operating expenses, such as salaries and employees benefits, depreciation on capital assets, repairs and maintenance and other general administrative expenses; and non-operating revenues and expenses, such as the operating grants from the Commonwealth of Puerto Rico, interest and investment income, and interest expense. The focus of the statement of revenues, expenses, and changes in net assets is the change in net assets. This is similar to net income or loss and portrays the results of operations of the Authority for the entire operating period.

Statement of Cash Flows
The statement of cash flows discloses net cash provided by or used for operating activities, investing activities, noncapital financing activities, and from capital and related financing activities. This statement also portrays the health of the Authority in that current cash flows are sufficient to pay current liabilities.

Notes to Financial Statements

The notes to financial statements are an integral part of the basic financial statements and describe the significant accounting policies, related-party transactions, deposits and investments, capital assets, long-term liabilities, defined-benefit pension plans, and the commitments and contingencies. The reader is encouraged to review the notes in conjunction with the management discussion and analysis and the financial statements.

Financial Analysis of the Authority's Business-Type Activities

Statements of Net Assets

The following table reflects a condensed summary of assets, liabilities, and net assets of the Authority as of June 30, 2012, 2011, and 2010:

	June 30,		
	2012	**2011**	**2010**
ASSETS			
Current assets	$ 6,563,645	$ 5,113,167	$ 6,903,253
Capital assets	60,282,068	52,952,902	44,278,250
Total assets	$ 66,845,713	$ 58,066,069	$ 51,181,503
LIABILITIES			
Current liabilities	$ 26,805,248	$ 25,055,824	$ 27,490,568
Long-term liabilities	50,695,557	41,118,278	50,190,213
Total liabilities	77,500,805	66,174,102	77,680,781
NET ASSETS			
Invested in capital assets, net of related debt	56,976,740	49,588,623	39,699,294
Deficiency in unrestricted net assets	(67,631,832)	(57,696,656)	(66,198,572)
Total net assets	(10,655,092)	(8,108,033)	(26,499,278)
Total liabilities and net assets	$ 66,845,713	$ 58,066,069	$ 51,181,503

June 30, 2012

Current assets increased by 28.37% to $6.6 million. The change in current assets is primarily due to an increase in expenses prepaid related to a contract to rent certain vessels to provide transportation services.

Capital assets increased by 13.84% to $60.2 million due to the acquisition and improvements of maritime transportation equipment, piers and terminals structures. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a sub recipient from the Puerto Rico Ports Authority (Ports Authority) of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the Federal Transit Administration which is used to finance the capital improvement program. Total capital grants received from the Federal Transit Administration and the Commonwealth of Puerto Rico during fiscal year end 2012 amounted to approximately $8.4 million.

Current liabilities increased by 6.98% to $26.8 million. This increase consists principally of an increase of $2.6 million accounts and accrued expenses payable.

Non-current liabilities consist principally of amounts due to Puerto Rico Ports Authority (PRPA), Puerto Rico Highways and Transportation Authority (PRPHA), and the long-term portion of compensated absences and voluntary termination benefits. The increase in these liabilities during fiscal year 2012 is due to funds provided by PRPHA under an agreement in which PRPHA will advance the Authority up to $24 million. These advances will be used to pay certain operating expenses as approved by PRPHA. During the year ended June 30, 2012 PRPHA paid expenses on behalf of the Authority in the amount of approximately $10.4 million.

In addition during the year ended June 30, 2012 the Commonwealth of Puerto Rico paid $2.9 of the amounts due to the Puerto Rico Ports Authority.

Other changes in non-current liabilities consists of net increase in voluntary termination benefits due to the implementation of Law 70 of the Commonwealth of Puerto Rico as explained below.

Deficiency in net assets increased 31.41% to $10.7 million. This increase was the result of an excess of expenses (operating and non-operating) over revenues (operating and non-operating) and capital grants of $2.5 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

June 30, 2011

Current assets decreased by 25.9% to $5.1 million. The change in current assets is primarily due to a decrease in capital contributions receivables from the Federal Transit Administration of $1.5 million as compared to last year receivable.

Capital assets increased by 19.6% to $53 million due to the acquisition and improvements of maritime transportation equipment, piers and terminals structures. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto

Rico. In addition, the Authority is a sub recipient from the Puerto Rico Ports Authority (Ports Authority) of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the Federal Transit Administration which is used to finance the capital improvement program. Total capital grants received from the Federal Transit Administration and the Commonwealth of Puerto Rico during fiscal year 2011 amounted to approximately $7.6 million.

Current liabilities decreased by 9% to $25.1 million. This decrease consists principally of a decrease of $2.2 million in property insurance premium payable recorded as a prepaid in the current year.

Long-Term Debt decrease of 18.1% to $41.1 million consists principally of a decrease of $15 million of amounts due to the Puerto Rico Ports Authority amounting to approximately $39.2 million in 2011 and $50.2 million in 2010. This amount consists of advances for the payment of operating expenses. This amount bears no interest and has no formal repayment terms and will be paid as cash becomes available, principally from operating grants from the Commonwealth of Puerto Rico which amounted to $15 million during 2011.

In addition during the year ended June 30, 2011 long-term liabilities includes advances received from the Puerto Rico Highways and Transportation Authority in the amount of approximately $3.8 and a liability of approximately $1.9 million for voluntary termination benefits explained below.

Deficiency in net assets decreased 69.4% to $8.1 million. This decrease was the result of an excess of revenues (operating and non-operating) over expenses (operating and non-operating) and capital grants of $18.4 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

The following table reflects a condensed summary of the revenues, expenses, and changes in net assets for the years ended three years ended June 30, 2012:

	Years Ended June 30,		
	2012	**2011**	**2010**
Operating revenues	$ 4,730,444	$ 4,257,995	$ 4,611,986
Operating expenses	44,374,214	41,576,481	33,285,467
Operating loss	(39,643,770)	(37,318,486)	(28,673,481)
Non-operaing revenues:			
Operating grants	28,715,687	44,113,321	21,774,634
Interest income (expense), net	(58,228)	(67,093)	(106,355)
Total non-operating revenues	28,657,459	44,046,228	21,668,279
Loss before capital contributions	(10,986,311)	6,727,742	(7,005,202)
Capital contributions	8,439,251	11,663,504	10,070,569
Change in net assets	(2,547,060)	18,391,246	3,065,367
Net assets deficit at beginning of year	(8,108,032)	(26,499,278)	(29,564,645)
Net assets deficit at end of year	$(10,655,092)	$ (8,108,032)	$(26,499,278)

Year Ended June 30, 2012

Operating revenues consisted of passenger, cargo and rental charges, increase by11.1% to $4.7 million mainly due to an increase in patronage during the year.

Operating expenses consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased 6.73%, to $44.3 million. This increase was due mainly to the impact to the adoption of a voluntary retirement benefit pan as explained below.

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 Authority. 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' salary, as defined. In this early retirement benefit program, the Authority 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 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 Commonwealth of Puerto Rico.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of $4 million in the statement of net assets as of June 30, 2012 and a charge of $2.1 million in the statement of activities for the year ended June 30, 2012. At June 30, 2012, unpaid long-term benefits granted on this program were discounted at 1.89%.

Non-operating revenues consisted principally of operating grants from the Commonwealth of Puerto Rico and Federal Transit Administration. Operating grants from the Commonwealth of Puerto Rico are annual appropriations from the general fund of the Commonwealth of Puerto Rico. The amount appropriated annually depends on the approved budget of the Commonwealth of Puerto Rico. Operating grants from Federal Transit Administration are restricted to maintenance activities of certain capital assets.

Capital contributions represent amounts received as sub recipient from the Puerto Rico Ports Authority under grants from Federal Transit Administration and from the Commonwealth of Puerto Rico which are restricted to the acquisition and repairs of certain capital assets.

Year Ended June 30, 2011

Operating revenues consisted of passenger, cargo and rental charges, decreased by 7.7% to $4.3 million mainly due to a decrease in vessels size and trips to Culebra due to pier repairs during the year.

Operating expenses consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased 24.9%, or $8.3 million to $41.6 million. This increase was due mainly to an increase in repairs and maintenance costs of $3.1 million as a result of the scheduled dry-dock overhauling of vessels, the increase in diesel consumption by bigger vessels like Cayo Blanco (new addition to the fleet) and the increase in the use of Cayo Largo throughout the year and the increase in compensation for the benefits of a voluntary termination benefit adopted during the year.

During the year ended June 30, 2011 the Authority adopted a voluntary benefit retirement plan as explained above. The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of $2,058,600 in the statement of net assets as of June 30, 2011 and a charge of $2,131,200 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 2.99%.

Non-operating revenues consisted principally of operating grants from the Commonwealth of Puerto Rico and Federal Transit Administration. Operating grants from the Commonwealth of Puerto Rico are annual appropriations from the general fund of the Commonwealth of Puerto Rico. The amount appropriated annually depends on the approved budget of the Commonwealth of Puerto Rico. Operating grants from Federal Transit Administration are restricted to maintenance activities of certain capital assets.

Capital contributions represent amounts received as sub recipient from the Puerto Rico Ports Authority under grants from Federal Transit Administration and from the Commonwealth of Puerto Rico which are restricted to the acquisition and repairs of certain capital assets.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2012, the Authority had invested approximately $60.2 million in capital assets (net of related depreciation) including maritime transportation equipment, improvements to piers and other structures used in the operations and construction in progress. At June 30, 2011, the Authority had invested approximately $52.9 million in capital assets.

Major capital assets events during the years ended June 30, 2012 includes the acquisition and repairs of maritime transportation equipment which were funded principally by capital contributions received.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our patrons, and other interested parties with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have question or need additional financial information, contact the Puerto Rico and Municipal Islands Maritime Transport Authority, Finance Area, P.O. Box 4306, Puerto Real, Puerto Rico 00740.

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET ASSETS
JUNE 30, 2012

ASSETS:	
CURRENT ASSETS	
Cash and cash equivalents	$ 462,240
Accounts receivable	673,462
Inventory	62,582
Prepaid expenses	5,365,361
Total current assets	6,563,645
CAPITAL ASSETS, net of accumulated depreciation	60,282,068
Total assets	$ 66,845,713
LIABILITIES:	
CURRENT LIABILITIES:	
Borrowings under line of credit	$ 126,203
Checks issued over bank balance	481,884
Accounts and accrued expenses payable	18,891,420
Deferred revenue	7,305,741
Total current liabilities	26,805,248
NON-CURRENT LIABILITIES:	
Due to other governments of instrumentalities	46,796,853
Voluntary termination benefits	3,687,929
Compensated absences	210,775
Total long-term liabilities	50,695,557
Total liabilities	77,500,805
NET ASSETS DEFICIENCY:	
Invested in capital assets, net of related debt	56,976,740
Unrestricted deficit	(67,631,832)
Net assets deficiency	(10,655,092)
Total liabilities and net assets deficiency	$ 66,845,713

The accompanying notes are integral part of the financial statements

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED JUNE 30, 2012

OPERATING REVENUES:	
Passenger and cargo revenues	$ 4,544,083
Equipment and property rentals	186,361
Total operating revenues	4,730,444
OPERATING EXPENSES:	
Salaries and employee benefits including voluntary termination benefits of $2,100,916	21,049,438
Depreciation and amortization	3,357,137
Repairs and maintenance	4,368,441
Insurance	2,689,031
Professional services	2,882,323
Diesel	5,723,523
Vessels rentals	2,845,214
General and administrative	1,459,107
Total operating expenses	44,374,214
OPERATING LOSS	(39,643,770)
NON-OPERATING REVENUES (EXPENSES)	
Operating grants:	
Commonwealth of Puerto Rico	27,554,000
Federal Transit Administration	1,161,687
Interest and other financing expenses, net	(58,228)
Total non-operating revenues	28,657,459
LOSS BEFORE CAPITAL CONTRIBUTIONS	(10,986,311)
CAPITAL CONTRIBUTIONS	8,439,251
CHANGE IN NET ASSETS	(2,547,060)
NET ASSETS DEFICIENCY:	
Beginning of year	(8,108,032)
End of year	$(10,655,092)

The accompanying notes are integral part of the financial statements

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2012

OPERATING ACTIVITIES:	
Cash received from customers and users	$ 4,510,712
Cash payments to suppliers for goods and services	(10,366,712)
Cash payments to employees for services	(18,909,377)
Net cash used in operating activities	(24,765,377)
NON-CAPITAL FINANCING ACTIVITIES:	
Operating grants:	
Commonwealth of Puerto Rico	24,604,000
Federal Transit Administration	1,161,687
Net change in checks issued over bank balance	(982,722)
Interest paid	(72,574)
Net cash provided by non-capital financing activities	24,710,391
CAPITAL AND RELATED FINANCING ACTIVITIES:	
Acquisition of capital assets	(11,048,282)
Capital contributions	11,053,549
Net cash provided by (used in) capital and related financing activities	5,267
FINANCING ACTIVITIES:	
Due to other govermental entities	221,434
NET INCREASE IN CASH AND CASH EQUIVALENTS	171,715
CASH AND CASH EQUIVALENTS:	
Beginning of year	290,525
End of year	$ 462,240

The accompanying notes are integral part of the financial statements

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF CASH FLOWS
YEAR ENDED JUNE 30, 2012

RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN BY OPERATING ACTIVITIES:	
Operating loss	$(39,643,770)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	3,357,137
Operating expenses paid by Puerto Rico Highways Transportation Authority	10,331,941
Decrease in capital assets	303,028
Changes in operating assets and liabilities:	
Accounts receivable	(219,732)
Prepaid expenses	(3,590,648)
Accounts and accrued expenses payable	4,696,667
Net cash used in operating activities	$(24,765,377)
NON-CASH TRANSACTIONS:	
Accounts payable incurred in the acquisition of capital assets	$ 3,305,528
Operating expenses paid by Puerto Rico Highways and Transportation Authority on behalf of the Authority	$10,331,941
Payment by Commonwealth of Puerto Rico of amounts due to Puerto Rico Ports Authority	$ 2,950,000

The accompanying notes are integral part of the financial statements

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Puerto Rico and Municipal Islands Maritime Transport Authority ("the Authority") is a public corporation and instrumentality of the Commonwealth of Puerto Rico, created by Act No. 1 approved on January 1, 2000, as amended, to administer and operate the maritime transportation services between Hato Rey and San Juan and Fajardo, Vieques and Culebra. The Authority is a component unit of the Commonwealth of Puerto Rico and accordingly is included in the general-purpose financial statements of the Commonwealth. The powers normally exercised by a Board of Directors are vested with the Secretary of the Department of Transportation and Public Works (DTPW). The Authority is exempt from the payment of any taxes on its revenues and properties.

The accounting and reporting policies of the Authority conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Authority follows the Governmental Accounting Standard Boards ("GASB") under the hierarchy established by Statement No. 55, The Hierarchy of Generally Accepted Accounting Principles for States and Local Governments, in the preparation of its financial statements.

The Authority adopted the provisions of Governmental Accounting Standards Board Statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting ("GASB 20"). In adopting GASB 20, the Authority elected to apply all Statements and Interpretations of the Financial Accounting Standards Board ("FASB"), Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Authority has elected not to apply FASB statements issued after November 30, 1989

Measurement Focus and Basis of Accounting

The operations of the Authority are accounted for as enterprise fund. Enterprise funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenue is recorded when earned, and expenses are recorded at the time liabilities are incurred. Enterprise funds are used to account for those operations for which the pricing policies of the entity establish fees and charges designed to recover its costs, including capital costs such as depreciation and debt service.

Use of Estimates

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

Cash and Cash Equivalents

In the statement of cash flows, cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and are so near to their maturity that they present insignificant risk of changes in value because of changes in interest rates. In particular, they include cash on hand and on deposit and short-term investments with maturities of three months or less.

Receivables

Receivables include amounts due from tenants for the use of facilities under rental and concession agreements. All receivables are current and therefore due within one year. Receivables are reported net of an allowance for uncollectible accounts and revenues net of uncollectable. Allowances are reported when accounts are proven to be uncollectible.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is an amount that management believes will be adequate to absorb possible losses on existing accounts receivable that may become uncollectible based on evaluations of collectability of accounts receivable and prior credit loss experience. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the existing accounts receivable and related allowance may change in the future.

Inventories

Inventories, consisting of fuel, materials and supplies are valued at the lower of cost (first-in, first-out method) or market.

Capital Assets

Capital assets are recorded at historical cost or estimated historical cost, net of accumulated depreciation and amortization. Contributions of assets from lessees are recorded at fair market value at the date donated. Capital asset is defined by the Authority as assets with an initial cost of more than $500 and an estimated useful life of more than one year. Depreciation and amortization is computed on a straight-line method over estimated useful lives of the related asset. Maintenance and repairs are charged to operations, while renewals and betterments are capitalized. When property and equipment are disposed of, the cost and applicable accumulated depreciation and amortization are removed from the respective accounts and the resulting gain or loss is recorded in operations.

The Authority periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No evidence of impairment is evident as a result of such review.

Vacation and Sick Leave

Compensated absences are accrued when earned by the employees. Employees may carry forward their compensated absences as permitted by statute and may settle them in a cash payment from the Authority, if employment has ceased.

Net assets

Net assets are classified in the following two components in the accompanying statements of net assets:

Invested in Capital Assets, Net of Related Debt

This component of net assets consist of capital assets net of accumulated depreciation and reduced by the outstanding balance of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of this component of net assets. Rather that portion of the debt is included in the same net asset component as the unspent proceeds.

Unrestricted

Unrestricted net assets consist of net assets that do not meet the definition of invested in capital assets, net of related debt.

Operating Revenues and Expenses

The Authority distinguishes between operating and non operating revenues and expenses in its Statement of Revenues, Expenses, and Changes in Net Assets. The principal revenues of the Authority are charges received from patrons for the maritime transportation services provided. The Authority also recognizes as operating revenue the rental fees received from concessionaires from operating leases on concession property. Operating expenses for the Authority include the costs of operating the maritime facilities and related rental spaces, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as no operating revenues and expenses.

Contributions

The Authority is a subrecipient of Federal funds received by the Puerto Rico Ports Authority under grants with Federal Transit Administration (FTA) for the exclusive purpose of acquisition and repairs of certain capital assets. Capital grants of the Authority are reported as non-operating revenues rather than contributed capital as required by GASB Statement No 33, *Accounting and Financial Reporting for Non-exchange Transactions.*

In addition, the Authority receives capital and operating grants from the Commonwealth of Puerto Rico. These grants, are subject to annual appropriations, are used to finance the Authority's operations or acquisition of capital assets.

Risk Financing

The Authority carries commercial insurance to cover casualty, theft, claims and other losses. The current insurance policies have not been cancelled or terminated. The Authority has not settled any claims in excess of its insurance coverage during the past three years. The Authority also pays premiums for workers compensation insurance to another component unit of the Commonwealth of Puerto Rico.

Recently Adopted GASB Statements

The Authority has completed the process of evaluating GASB Statement No. 54, Fund Balance reporting and Governmental Fund Type Definitions. This statement establishes accounting and financial reporting standards for all governments that report governmental funds. It establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types. The Authority has determined that GASB No. 54 will have no impact on its financial position, results of operations, and cash flows and therefore it is not applicable to its operation.

The Authority has completed the process of evaluating the impact that will result from implementing GASB Statement No. 59, Financial Instruments Omnibus which is effective for fiscal years beginning after June 15, 2010 . The Statement updates and improves existing standards regarding financial reporting of certain financial instruments and external investment pools. The Authority has determined that GASB No. 59 will have no impact on its financial position, results of operations, and cash flows and therefore it is not applicable to its operation at the present time.

Recently Statements Issued by GASB

The GASB has issued Statement No. 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans which is effective for fiscal years beginning after June 15, 2011. This statement amends Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits other Than Pensions, and Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. This Statement clarifies actuarially determined OPEB measures reported by an agent multiple-employer OPEB plan and its participating employers. Those measures should be determined by a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirement. The Authority has not yet determined the effect, if any, that the adoption of GASB 57 may have on its financial statements.

The GASB has also issued Statement No. 60, Accounting and Financial Reporting for Service Concession Arrangements (SCA) which is effective for fiscal years beginning after December 15, 2011. The requirement of this statement improve financial reporting by establishing recognition, measurement and disclosure requirements for SCAs for both transferors and governmental operators, requiring governments to account for and report SCAs in the same manner, which improves the comparability of financial statements. The Authority has not yet determined the effect, if any, that the adoption of GASB 60 may have on its financial statements.

The GASB has also issued Statement No. 61, The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements Nos. 14 and 34 which is effective for fiscal years beginning after December 31, 2011. The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. The Authority has not yet determined the effect, if any, that the adoption of GASB 61 may have on its financial statements.

The GASB has also issued Statement No. 62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 1989 FASB and AICPA Pronouncements which is effective for fiscal years beginning after December 15, 2011. The objective of this statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance included in the FASB and AICPA pronouncements issued on or before November 30, 1989. This statement will improve financial reporting by contribution to the GASB's effort to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. The Authority has not yet determined the effect, if any, that the adoption of GASB 62 may have on its financial statements.

The GASB has also issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position which is effective for fiscal years beginning after December 15, 2011. The Statement objective is to provide a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position (which is the net residual amount of the other elements). The Statement requires that deferred outflows of resources and deferred inflows of resources be reported separately from assets and liabilities. The Authority has not yet determined the effect, if any, that the adoption of GASB 63 may have on its financial statements.

The GASB has also issued Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions which is effective for fiscal years beginning after June 15, 2011. The Statement will improve financial reporting by state and local governments by clarifying the circumstances in which hedge accounting continues to be applied when a swap counterparty, or a swap counterparty's credit support provider, is replaced. The Statement clarifies that when certain conditions are met, the use of hedge accounting should not be terminated. Those conditions are: (1) the collectability of swap payments is considered to be probable, (2) the replacement of the counterparty or credit support provider meets the criteria of an assignment or in-substance assignment as described in the Statement, and (3) the counterparty or counterparty credit support provider (and not the government) has committed the act of default or termination event. When all of these conditions exist, the GASB believes that the hedging relationship continues and hedge accounting should continue to be applied. The Authority has not yet determined the effect, if any, that the adoption of GASB 64 may have on its financial statements.

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at June 30, 2012 consist of cash on hands and on deposit.

The Authority is restricted by law to deposit funds only in institutions approved by the Puerto Rico Treasury Department, and such deposits are required to be kept in separate accounts in the name of the Authority.

Pursuant to the Investment Guidelines for the Commonwealth adopted by Government Development Bank for Puerto Rico ("GDB"), the Authority may invest in obligations of the

Commonwealth, obligations of the United States, certificates of deposit, commercial paper, repurchase agreements, bankers acceptances, or in pools of obligations of the municipalities of Puerto Rico, among others. There are no investments at June 30, 2012.

For deposits, custodial credit risk is the risk that in the event of bank failure, the Authority's deposits may not be returned to it. Under Puerto Rico statutes public funds deposited in commercial bank must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth of Puerto Rico. The bank balance of the Authority's deposit at June 30, 2012, excluding deposits in Government Development Bank for Puerto Rico described below, amounted to $367,134, respectively, of which $250,000 is insured by Federal Deposit Insurance Corporation at June 30, 2012.

In addition, at June 30, 2012, the Authority maintained cash deposited at the Governmental Development Bank for Puerto Rico (GDB), in the amount of $28,009. This amount is uncollateralized since by law, the governmental banks of the Commonwealth of Puerto Rico are exempt of the requirement of insuring the deposits of funds of the entities of the Commonwealth of Puerto Rico.

2. ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2012:

Federal Transit Administration	$ 136,907
Agencies, public corporations and municipalities of the Commonwealth of Puerto Rico	403,178
Customers and other	301,066
Total	841,151
Less allowance for doubtful accounts	167,689
Accounts receivable net	$ 673,462

Amounts due by Federal Transit Administration represent capital and operating grants pending of collection at the end of the fiscal year. Such amounts were collected after the end of the fiscal year.

3. CAPITAL ASSETS

The following schedule summarizes the capital assets held by the Authority as of June 30, 2012:

	Balance at June 30, 2011	Increases	Decreases	Balance at June 30, 2012
Assets not being depreciated:				
Land and improvements	$ 93,323	$ -	$ -	$ 93,323
Construction in progress	15,936,962	10,590,465	(426,349)	26,101,078
Total	16,030,285	10,590,465	(426,349)	26,194,401
Assets being depreciated:				
Buildings and piers	4,184,697	123,321	-	4,308,018
Maritime and other transportation equipment	59,764,490	-	-	59,764,490
Motor vehicles	292,968	49,012		341,980
Furniture and equipment	2,275,636	349,854	-	2,625,490
Total	66,517,791	522,187	-	67,039,978
Accumulated depreciation	29,595,174	3,357,137	-	32,952,311
Capital assets being depreciated, net	36,922,617	(2,834,950)	-	34,087,667
Total capital assets, net	$ 52,952,902	$ 7,755,515	$ (426,349)	$ 60,282,068

4. BORROWINGS UNDER LINE OF CREDIT

During fiscal year 2008, the Government Development Bank ("GDB") approved an unsecured line of credit in which the Authority may borrow up to $1,500,000 which was due effective June 30, 2008. Outstanding borrowings bear interest at the three months LIBOR plus 125 base points.

A summary of the activity in the line of credit during the years ended June 30, 2012 follows:

	Balance at 2011	Increases	Decreases	Balance at 2012	Current Portion
Borrowings under line of credit	$ 126,203	$ -	$ -	$ 126,203	$ 126,203

5. ACCOUNTS AND ACCRUED EXPENSES PAYABLE

Accounts and accrued expenses payable at June 30, 2012 consist of:

Trade payable	$ 11,804,112
Agencies and public corporations of the Commonwealth of Puerto Rico	4,135,068
Compensated absences	1,239,379
Voluntary termination benefits	348,216
Accued legal claims	463,971
Other accrued expenses	900,674
Total	$ 18,891,420

Amounts due to agencies and public corporations of the Commonwealth of Puerto Rico represents liabilities for payroll taxes withholdings, workmen's compensation insurance, utilities and other related services.

6. DUE TO OTHER GOVERNMENT OR INSTRUMENTALITIES

Due to other governmental instrumentalities classified as long-term liabilities at June 30, 2012 consist of:

	Balance at 2011	Increases	Decreases	Balance at 2010	Current Portion
Puerto Rico Ports Authority	$35,383,320	$ 221,434	$ (2,950,000)	$32,654,754	$ -
Puerto Rico Highways and Transportation Authority	3,810,158	10,331,941	-	14,142,099	-
Total	$39,193,478	$10,553,375	$ (2,950,000)	$46,796,853	$ -

Amount due to the Puerto Rico Ports Authority consist of advances for the payment of operating expenses. This amount bears no interest and has no formal repayment terms. The amount outstanding will be paid as cash becomes available, principally from operating grants from the Commonwealth of Puerto Rico. During the year ended June 30, 2012 the Commonwealth of Puerto Rico paid $2.9 million of the amount due by the Authority.

During the year ended June 30, 2012, the Authority made an agreement with the Puerto Rico Highways and Transportation Authority ("PRHTA") in which PRHTA will advance a total of $24 million to be used for different purposes. The agreement requires that the use of the money be approved and supervised by PRPHA. The advances will be used principally for operational purposes including, among others, repairs of vessels, rent of vessels, payment of insurance policies and professional services. The amount advanced bears no interest and have no formal repayment plan. The amount outstanding will be paid as cash becomes available, principally from operating grants from the Commonwealth of Puerto Rico.

7. DEFERRED REVENUE

Deferred revenues at June 30, 2012 consist principally of federal funds requested to finance the acquisition of a ferry boat which was already financed with funds from the Commonwealth of Puerto Rico as explained below and other federal grants questioned costs.

During July 2007, the Legislature of the Commonwealth of Puerto Rico approved Resolution No 116 which authorized the Secretary of the Treasury of the Commonwealth of Puerto Rico to transfer $9,000,000 to the Authority for the sole purpose of financing the acquisition of ferry boats. Management used these funds to finance a ferry boat of 600 passengers with a total cost approximately $10,600,000.

During the year ended June 30, 2010 and 2009 management requested federal assistance to the Federal Transit Administration (FTA) through the Puerto Rico Ports Authority, the grantee, to finance the same 600 passenger boat. Approval from FTA was obtained and the Authority received $6,825,119 in federal assistance. The excess funds received between the federal funds and the funds received under Resolution No 116 were used for operational purpose which is not an authorized used under the federal award or Resolution No 116. Management is in conversation with FTA to determine the course of action to correct this situation. The amount of the funds received and improperly used has been recorded as deferred revenue in the accompanying statements of net assets.

8. NON-CURRENT LIABILITIES

Changes in noncurrent liabilities, other than the amounts due to governmental entities described above, for the year ended June 30, 2012 are summarizes as follows:

	Balance at 2011	Increases	Decreases	Balance at 2012	Due Within One Year
Compensated absences	$ 1,400,821	$ 868,647	$ (819,314)	$ 1,450,154	$ 1,239,379
Voluntary termination benefits	2,058,600	2,100,916	(123,371)	4,036,145	348,216
Total	$ 3,459,421	$ 2,969,563	$ (942,685)	$ 5,486,299	$ 1,587,595

9. RETIREMENT PLAN

Defined Benefit Plan

The Government of Puerto Rico Employees Retirement System (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth of Puerto Rico ("the Commonwealth"). All regular employees of the Authority under the age of 55 at the date of employment become members of the ERS as a consequence of their employment.

The ERS provides retirement, death, and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, which became effective on January 1, 1952. Disability retirement benefits for occupational and non-occupational disabilities are available to members enrolled in the plan before January 1, 2000. Benefits vest after ten years of plan participation.

The amount of the annuity shall be one and one half percent (1.5%) of the average compensation multiplied by the number of years of creditable service up to twenty (20) years, plus two percent (2%) of the average compensation multiplied by the number of years of creditable service in excess of twenty years. In no case shall the annuity be less than $200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive a Merit Annuity. Such participants who have not attained fifty-five years of age will receive 65% of the average compensation or if they have attained fifty-five years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten years of service. No benefits are payable if participants receive a refund of their accumulated contributions.

Commonwealth legislation requires that employees hired before April 1, 1990 contribute 5.775% of the first $550 of their monthly gross salary and 8.275% of their gross monthly salary in excess of $550. Employees hired after April 1, 1990 contribute 8.275% of their gross monthly salary. The Authority's contributions are 10.275% of the gross monthly salary. Total employer contributions during years ended June 30, 2012 under this plan amounted to approximately $456,000 million which represented 100% of required contributions.

Defined Contribution Plan
On September 24, 1999, an amendment to Act No. 447 of May 15, 1951, which created the ERS, was enacted for the purpose of establishing a new pension program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the ERS as of December 31, 1999 had the option to stay in the defined benefit plan or transfer to System 2000. Employees joining the Authority on or after January 1, 2000 are only allowed to become members of System 2000.

System 2000 is a defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the ERS, together with those of the current defined benefit plan. Benefits at retirement age are not guaranteed by the Commonwealth. The annuity is based on a formula that assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) is invested in an account, which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or (2) earn a rate equal to 75% of the return of the ERS' investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000.

Total Authority's contributions during the fiscal year ended June 30, 2012 under this plan amounted to approximately $335,000, which represented 100% of required contributions.

Additional information on the ERS is provided in its financial statements for the year ended June 30, 2012 a copy of which can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

10. OTHER POST EMPLOYMENT BENEFITS

The Authority provides certain post-employment benefits to eligible employees in accordance with collective bargain agreements. These benefits consist principally of medical insurance coverage for a period not to exceed 5 years after retirement and bonus at retirement date based on years of services. The cost of these benefits is recorded in the financial statements when the related benefit is paid.

11. COMMITMENTS AND CONTINGENT LIABILITIES

Leases

The Authority has various non-cancelable operating leases for office space and pier facilities which expire through July 2025. Most of these leases are with the Puerto Rico Ports Authority, a component unit of the Commonwealth of Puerto Rico. The rental expense for the year ended June 30, 2012 was approximately $83,500. Future rental payments as of June 30, 2012 under these leases are as follows:

Year Ending June 30,	Amount
2013	$ 72,000
2014	60,600
2015	60,600
2016	31,400
2017	31,400
2018-2022	158,600
2023-2025	96,500
Total	$ 511,100

Litigation

The Authority is involved in litigation arising in the normal course of operations. Management believes that its ultimate liability, if any, in connection with these matters will not have a material effect on the Authority's financial condition and results of operations. Due to uncertainties in the settlement process, it is at least reasonably possible that management's view of the outcome of these claims will change in the near term. Based on advice of legal counsel, management has recorded an estimated litigation and claim loss of approximately $464,000 as of June 30, 2012.

Federal Assistance Programs

The Authority is a sub recipient of a federal financial assistance program. This program is subject to audits in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, or to compliance audits by grantor agencies. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time, although the Authority expects such amounts, if any, not to be significant.

Construction
At June 30, 2012 the Authority has outstanding construction commitment for the construction and improvements of piers and terminals in the amount of approximately $11.7 million.

Vessel Rentals
The Authority had an agreement with a private entity for the rental of certain vessels. This contract was due on January 2012 and the total paid during the year ended June 30, 2012 amounted to approximately $1.7 million.

As part of the agreement with PRTHA described in Note 6, PRHTA made an agreement on behalf of the Authority with a private entity for the rental of certain vessels to be used in providing transportation services to the islands of Vieques and Culebra. The contract expires on March 2013 and is for a maximum amount of $12.7. During the year ended PRHTA billed the Authority $4.8 million for amounts paid under the term of this contract. Of the total amount billed $3.7 is related to activities under the contract before the commencement of the transportation services and therefore the amount is recorded as prepaid expenses. This amount will be amortized over a period of 9 months to March 2013. The statement of revenues and expenses includes $1.1 million related to this contract.

12. 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 Authority. 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' salary, as defined. In this early retirement benefit program, the Authority 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 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 Commonwealth of Puerto Rico.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately $4 million in the statement of net assets as of June 30, 2012 and a charge of $2.1 million in the statement of activities for the year ended June 30, 2012. At June 30, 2012, unpaid long-term benefits granted on this program were discounted at 1.89%.

13. OPERATING FINANCIAL ASSISTANCE FROM THE COMMONWEALTH OF PUERTO RICO

As shown in the accompanying financial statements the Authority has incurred in accumulated losses after operating and capital contributions in the amount of $2.5 million and as of June 30, 2012 the Authority's liabilities exceeded its assets by approximately $10.7 million. In addition, at June 30, 2012 the Authority has a working capital deficiency of approximately $20.2 million making it difficult for the Authority to pay its liabilities in the normal course of business. These facts indicate that the Authority needs the continued support from the Commonwealth of Puerto Rico in the form of operating grants to continue to operate at its present level and to continue as a going concern. The Commonwealth of Puerto Rico has experienced budget constrains during the current and prior years which have resulted in reductions in the operating grants provided to the Authority. Management believes that since the maritime service provided by the Authority to the residents of Vieques and Culebra is an essential service, the Commonwealth will continue to fund the operational deficits incurred by the Authority. Any significant reduction in these operating grants and financial support will affect the ability of the Authority to provide the maritime services and to continue as a going concern.

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2012

Federal Grantor/Pass-Trough Grantor/ Program Title	Federal CFDA Number	Federal Expenditures
Federal Transit Administration		
Pass-Trough Puerto Rico Ports Authority		
Federal Transit Administration Formula Grant	20.507	$ 1,702,271
ARRA - Federal Transit Administration Formula Grant	20.507	1,952,270
Total expenditures of federal awards		$ 3,654,541

PUERTO RICO AND MUNICIPAL ISLANDS MARITIME TRANSPORT AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2012

General
The accompanying schedule of expenditures of federal awards presents the activity of federal awards programs of the Puerto Rico and Municipal Islands Maritime Transport Authority ("the Authority"), a component unit of the Commonwealth of Puerto Rico. The Authority reporting entity is defined in Note 1 to the Authority's basic financial statements. All federal awards received directly from federal agencies as well as federal awards passed through other governmental agencies are included in the schedule of expenditures of federal awards.

Basis of Accounting
The accompanying schedule of expenditures of federal awards is presented using the accrual basis of accounting which is described in Note 1 to the Authority's basic financial statements. Expenditures are determined using the cost accounting principles and procedures set forth in OMB Circular A-87, *Cost Principles for States, Local and Indian Tribal Governments.*

Reconciliation to Financial Statements
Information reported in the accompanying schedule of expenditures of federal awards agreed with or has being reconciled to the information reported in the Council's basic financial statements.

Pass-Through Awards
The Authority received its Federal Awards in the form of pass-through awards from the Puerto Rico Ports Authority as identified on the Schedule.

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

Hon. Rubén A. Hernández Gregorat, MEM, P.E.
Secretary Department of Transportation and Public Works

We have audited the financial statements of the Puerto Rico and Municipal Islands Maritime Transport Authority (the Authority) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 1, 2012.

Our report on the Authority's financial statements was qualified because the Authority was unable to determine the costs of the spare parts inventory that should be recorded in the financial statements. In addition the Authority did not provide an actuarial valuation report to record the liability and current year cost of the certain post-employment benefits as required by accounting principles generally accepted in the United States of America ("GAAP"). The cost of these benefits are recorded in the financial statements when paid which is a method not accepted by GAAP.

Except as discussed in the preceding paragraph, 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. As described in Note 13 to the financial statements the Authority depends on the continued operating assistance from the Commonwealth of Puerto Rico to continue to operate at its current level and to continue as a going concern.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority'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 Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

400 Américo Miranda Ave.
Cosvi Building 3rd Floor
San Juan, PR 00926
787.622.0029
787.622.0049
www.guzmantorres.com

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 the accompanying schedule of findings and questioned costs as items 12-FS-01 to 12-FS-03 and 12-FS-07 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 the accompany schedule of findings and questioned costs as item 12-FS-04 and 12-FS-06 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying schedule of findings and questioned costs as item 12-FS-05.

This report is intended solely for the information and use of the Authority's management, the audit committee, and the U.S. Department of Transportation and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Guzmán, Torres Castro & Díaz, CPA's PSC
CERTIFIED PUBLIC ACCOUNTANTS
October 1, 2012

Stamp #2667359 was affixed to the original of this report.

gt&d | guzmán torres castro & díaz., psc
certified public accountants & business advisors

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO THE MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OFFICE MANAGEMENT AND BUDGET (OMB) CIRCULAR A-133

Hon. Rubén A. Hernández Gregorat, MEM, P.E.
Secretary Department of Transportation and Public Works

Compliance

We have audited the Puerto Rico and Municipal Islands Maritime Transport Authority (the Authority) compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Authority's major federal programs for the year ended June 30, 2012. The Authority'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, regulation, contracts, and grants applicable to each of its major programs is the responsibility of Authority's management. Our responsibility is to express an opinion on Authority'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 Authority'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 Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 12-FS-01 and 12-FS-02.

400 Américo Miranda Ave.
Cosvi Building 3rd Floor
San Juan, PR 00926
787.622.0029
787.622.0049
www.guzmantorres.com

Internal Control Over Compliance

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

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

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 12-SA-02 to be a material weakness.

This report is intended solely for the information and use of the Authority's management, the audit committee, and the U.S. Department of Transportation and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Guzmán, Torres Castro & Diaz, CPA's PSC

CERTIFIED PUBLIC ACCOUNTANTS
October 1, 2012

Stamp # **2667360**
affixed to original of this report.

Section 1 – Summary of Auditors' Report

1. The type of opinion issued in the financial statements	Qualified
2. The independent accountants' report on internal control over financial reporting described:	
a. Significant deficiencies noted considered material weaknesses	Yes
b. Significant deficiency noted that is not considered to be a material weaknesses	Yes
3. Noncompliance considered material to the financial statements was disclosed by the audit	Yes
4. The independent accountants' report on internal control over compliance with requirements applicable to major Federal awards described:	
a. Significant deficiency noted considered to be a material weaknesses	Yes
b. Significant deficiency noted that is not considered to be a material weaknesses	No
5. The opinion expressed in the independent accountants' report on compliance with requirements applicable to major Federal awards	Unqualified
6. The audit disclosed findings to be reported in accordance with Section .510(a) of OMB Circular A-133	Yes
7. The Authority's major program was:	

Name of Federal Program or Cluster	CFDA No
Federal Transit Administration Formula Grants	20.507

8. The threshold used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133	$300,000

SECTION 2 - FINDINGS RELATING TO THE FINANCIAL STATEMENTS REPORTED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Finding 12-FS-01 (Material Weakness)

Condition:

During the audit a number of adjusting entries were made. Some of these entries were to adjust unrecorded liabilities, accrued expenses, depreciation and amortization among others.

Criteria:

Accounting principles generally accepted in the United States of America require that revenues and expense transactions be recognized in the period incurred under the accrual basis of accounting and that financial statements be prepared following such principles.

Cause of condition:

Significant accounts and transactions were not analyzed on a timely basis and therefore not properly recorded in the accounting records

Effect of condition:

Current year financial statements were materially misstated.

Recommendation:

In order to ensure that all accounting procedures are performed on a timely basis, management should establish policies to document the month and year end procedures that should be followed by the accounting department and well as any other department that provide financial information required for the preparation of financial statements. This could be accomplished by developing a comprehensive checklist to cover all procedures that the Authority determines need to be performed on a periodic basis including, but not limited to, month end procedures such as bank reconciliations, and general ledger account analysis, etc.

Finding 12-FS-02 (Material Weakness)

Condition:

The Authority has a parts inventory stored in a warehouse located at in the pier facilities in Fajardo and San Juan. When we inquiry about the parts inventory, management disclosed the following to us:

- During July and August 2012 the Authority performed a physical count of inventory parts but as of the date of this report the Authority has been unable to determine the cost of the parts inventory.
- Inventory has never been recorded in the Authority's financial statements.
- There could be obsolete parts stored in the warehouse but an assessment of obsolescence has not being performed.
- Inventory cards are kept manually, but are never reconciled with general ledger or other records.
- Inventory is not valued using any of the acceptable valuation methods allowed by accounting principles generally accepted in the United States of America (i.e.; FIFO, LIFO or Average). Instead parts are valued using the cost per the last vendor invoice.

Criteria:

Proper internal control procedures should exist to safeguard the parts inventory and to properly reflect such inventory in the Authority's financial statements as required by accounting principles generally accepted in United States of America.

Cause of condition:

Parts inventory is not properly safeguarded and therefore is subject to loss from intentional or unintentional errors. In addition, such inventory is not reflected in the Authority's financial statements as required by accounting principles generally accepted in United States of America.

Effect of condition:

The Authority could be incurring losses for improper handling of parts inventory such as unauthorized use, acquisition of parts over the required levels or for acquisition of parts not needed for current operations, among others. In addition, the Authority's financial statements could be materially misstated.

Recommendation:

Management should establish procedures to properly safeguard its parts inventory and to properly reflect such inventory in the Authority's financial statements. This could be accomplished by the establishment of a perpetual inventory system and formal inventory counting procedures. In addition, to assure that perpetual records present an accurate reflection of quantities on hand, a formal program of cycle counting procedures should be instituted. These procedures should include the following:

- Formal scheduling of items to be counted and periodic management review to assure adherence to the schedule.
- Reconciliation of perpetual records and actual counts.
- Adjustment of perpetual records to actual quantities resulting from known differences and documentation of the reasons for such adjustments.
- Follow-up to determine the causes for differences so that procedural weaknesses may be remedied.
- Periodic reporting to appropriate Authority personnel of the results of the cycle counting procedures.

Finding 12-FS-03 (Material Weakness)

Condition:

Cash receipts are not being deposited on a daily basis. Instead daily cash receipts are accumulated and used for the payment of expenses, and exchange fund.

Criteria:

Proper internal control procedures should exist to assure proper safeguarding of cash receipts. These procedures should require the daily deposit of all cash receipts and prohibition of use of sales receipts for the payment of expenses or exchange fund.

Cause of condition:

No formal policy exists that requires the daily deposit of intact sales receipts.

Effect of condition:

There is a risk of loss of cash receipts from burglary, misplacement of misappropriation of cash.

Recommendation:

We recommend that deposits be made on a daily basis both to improve cash flow and to reduce the risk of loss.

Finding 12-FS-04

Condition:

During our disbursement test, in certain instances we noted the following:

- The supplier invoice and the disbursement voucher were not stamped as paid or cancelled.
- Disbursement was done with a copy of the invoice instead of the original invoice.
- No receiving report was available for our examination.
- Certain approvals were missing from the disbursement package.
- Suppliers required certifications are missing.

Criteria:

Proper internal control procedures require that supplier invoices be properly intervened to avoid improper payments. In additions invoices should stamped as paid or cancelled to avoid double payment.

Cause of Condition:

No proper implementation of internal control procedures.

Effect of Condition:

No implementation of internal control procedures that require the pre-intervention of the disbursement package for all disbursement could expose the Authority to losses due to improper payments, double payments or for the payment of goods and services not received by the Authority.

Recommendation:

Internal control procedures that require the pre-intervention of all disbursement should be established and enforced at all times.

Finding 12-FS-05 (Material Non Compliance)

Condition:

At June 30, 2012 the Authority has amounts outstanding with other public corporations or agencies of the Commonwealth of Puerto Rico amounting to approximately $4.1 million. This amount represents amounts due for payroll withholdings, utilities, workmen's compensation insurance and other related services.

Criteria:

Laws and regulations require that amounts due to other entities of the Commonwealth of Puerto Rico be settled in the normal course of business.

Cause of Condition:

Cash flows problem has precluded the Authority from making payments to reduce such liabilities. The cash flows problem results principally operating losses incurred.

Effect of Condition:

The Authority is not in compliance with applicable laws and regulations. In addition, the Authority could incur in interest, and penalties on the accumulated debt.

Recommendation:

Management should look for financing alternatives to comply and pay these liabilities when due in accordance with laws and regulations in order to avoid the payment of interest and penalties.

Finding 12-FS-06

Condition:

At June 30, 2012 the Authority has accounts receivable outstanding in the amount of approximately $657,000 of which $510,000 is overdue or more than 90 days old. Some of the invoices that overdue dates back to various years ago. Of the total accounts receivable outstanding, approximately $403,000 is due by public corporations or agencies of the Commonwealth of Puerto Rico. Of such balance approximately $334,000 is overdue.

Criteria:

In order to improve the Authority's cash flows prompt follow up should be performed on all accounts receivable.

Cause of Condition:

No prompt follow up is performed on accounts receivable, especially balances considered overdue. For example no collection letters or statements of accounts are sent on a recurring basis.

Effect of Condition:

Failure to collect receivable promptly creates hidden expenses and result in reductions in the Authority's cash flows. Also the older a balance gets, the more difficult is to collect.

Recommendation:

To improve accounts receivable collections, we recommend that the following steps be considered:

1. Institute a credit policy that includes a specific credit limit for each customer.
2. Periodically review the aged trial balance and send letter to customers with balances over 90 days old. Follow up with a phone call if payment is not received after specified period after the letter is sent and attempt to determine the cause for non-payment and take corrective action accordingly.

Finding 12-FS-07 (Material Weakness)

Condition:

The Authority records the cost of certain post employment benefits provided to eligible employees in accordance with collective bargaining agreements when paid which is a method not accepted by accounting principles generally accepted in the United States of America ("GAAP").

Criteria:

GAAP requires that the cost and the liability for post employment benefits be determined using an actuarial valuation perform at least every two years. In addition GAAP requires that the cost of post employment benefits be recorded using the accrual basis of accounting.

Cause of Condition:

Management was unable to hire an actuary to perform the evaluation required by GAAP.

Effect of Condition:

The Authority's financial statements are not in accordance with GAAP and could be materially misstated.

Recommendation:

Management should hire an actuary to perform the evaluation required by GAAP. Financial statements should be adjusted accordingly.

SECTION 3 – FINDINGS AND QUESTION COSTS RELATING TO FEDERAL AWARDS

Finding 12-SA-01

Federal Program:

20.507 Federal Transit Administration Capital and Operating Assistance Formula Grants

Federal Grantor:

Federal Transit Administration

Pass Through Entity:

Puerto Rico Ports Authority

Compliance Requirement

Equipment and real property management

Reporting Requirement:

Material non-compliance in relation to a compliance requirement

Condition:

There is no physical inventory of equipment acquired with federal funds.

Criteria:

Federal laws and regulations require that proper records should be maintained for all equipment acquired with federal funds. In addition a physical inventory of the equipment acquired with federal funds should be taken at least once every two years and the count be reconciled with the equipment records.

Cause of Condition:

Management is in the process of implementing a capital ledger record system and as part of this process will perform the physical inventory count.

Effect of Condition:

The Authority is not in compliance with program laws and regulations.

Recommendation:

Proper controls and procedures should be established in order to assure compliance with program laws and regulations at all time.

Finding 12-SA-02

Federal Program:

20.507 Federal Transit Administration Capital and Operating Assistance Formula Grants

Federal Grantor:

Federal Transit Administration

Pass Through Entity:

Puerto Rico Ports Authority

Compliance requirements:

N/A

Reporting Requirement:

Material weakness in internal control over a major Federal program

Condition:

See Finding 12-FS-02. This finding relates to a material weakness in internal control over a major Federal program that is required to be reported under OMB Circular A-133.

Finding 11-SA-01

Federal Program:
20.507 Federal Transit Administration Capital and Operating Assistance Formula Grants

Federal Grantor:
Federal Transit Administration

Pass Through Entity:
Puerto Rico Ports Authority

Condition:
During the year ended June 30, 2011 the Authority issued a check in the amount of $320,353 to a supplier for the acquisition of certain spare parts. However as of the date of this report the spare parts have not being received.

Questioned costs:
$320,353

Recommendation:
Controls and procedures should be established that prohibit the use of federal funds to pay for goods or services that has not being received at the time of the payment. In addition management should prepare the list of the spare parts to be ordered in order to receive such parts in the near future.

Status of Corrective Action
Although no similar items were noted during current fiscal year audit, no evidence was provided for our examination that the parts were received during the year.

Finding 11-SA-01 and 10-SA-05

Condition:

The Authority has a parts inventory stored in a warehouse located at in the pier facilities in Fajardo and San Juan. When we inquiry about the parts inventory, management disclosed the following to us:

- Last physical count was performed in fiscal year 2002.
- Inventory has never been recorded in the Authority's financial statements.
- Inventory is stored in the warehouse, but some parts are not well organized.

- There could be obsolete parts stored in the warehouse but an assessment of obsolescence has not being performed.
- Inventory cards are kept manually, but are never reconciled with general ledger or other records.
- Inventory is not valued using any of the acceptable valuation methods allowed by accounting principles generally accepted in the United States of America (i.e.; FIFO, LIFO or Average). Instead parts are valued using the cost per the last vendor invoice.

Recommendation:

Management should establish procedures to properly safeguard its parts inventory and to properly reflect such inventory in the Authority's financial statements. This could be accomplished by the establishment of a perpetual inventory system and formal inventory counting procedures. In addition, to assure that perpetual records present an accurate reflection of quantities on hand, a formal program of cycle counting procedures should be instituted. These procedures should include the following:

- Formal scheduling of items to be counted and periodic management review to assure adherence to the schedule.
- Reconciliation of perpetual records and actual counts.
- Adjustment of perpetual records to actual quantities resulting from known differences and documentation of the reasons for such adjustments.
- Follow-up to determine the causes for differences so that procedural weaknesses may be remedied.
- Periodic reporting to appropriate Authority personnel of the results of the cycle counting procedures.

Status of Corrective Action:

Finding partially corrected. During the year the Authority performed a physical count of the spare parts during the months of July and August 2012. However the Authority has been unable to determine the cost of the spare parts in accordance with accounting principle generally accepted in the United States of America. Therefore a similar finding was reported during this year. See 12-SA-02.

Finding 10-SA-01

Federal Program:

20.507 Federal Transit Administration Capital and Operating Assistance Formula Grants

Federal Grantor:

Federal Transit Administration

Pass Through Entity:

Puerto Rico Ports Authority

Condition:

During the year ended June 30, 2010, the Authority requested federal funds for the acquisition of certain spare parts to be used in repairs and maintenance of the ferries. Then when the funds were received, they were used for the payment of a debt related to the acquisition of a ferry and not for the purchase of the spare part as approved.

Recommendation:

Controls and procedures should be established to assure that federal funds are used as approved and federal program compliance requirements is always adhered to.

Questioned Costs

$320,353

Status of Corrective Action:

Management position is that although the funds were not used for the approved purpose it was used in an allowable activity. Therefore management is in the process of discussing this finding with US Department of Transportation (US DOT) and is waiting for his final determination.

Reference No: 09-SA-01

Federal Program:

20.507 Federal Transit Administration Capital and Operating Assistance Formula Grants

Federal Grantor:

Federal Transit Administration

Pass Through Entity:

Puerto Rico Ports Authority

Condition:

During the year ended the Authority received funds from the Commonwealth of Puerto Rico which were restricted for the acquisition of ferry boats. These funds were used to finance the acquisition if a ferry boat of 600 passengers with an estimated total cost of $10.5 million. During the same fiscal year the Authority received from the Federal Transit Authority through the Puerto Rico Ports Authority $6.8 million to finance the same ferry boat resulting in funds received twice to finance the acquisition of the same capital asset. The excess funds received were used for operational purposes.

Recommendation:

The Authority should review information submitted in application to the Federal Transit Administration and monitoring procedures should be established to ensure that Federal Awards compliance requirements are always adhered to. Reimbursement should be requested only for allowable expenditures not previously reimbursed with other State or Federal funds.

Questioned Costs

$6,825,119

Status of Corrective Action:

No similar instances noted during the audit for the years ended June 30, 2012 and 2011. Management is in the process of discussing and submitting evidence to the US Department of Transportation (US DOT) about the federal awards expended. Finding is pending final determination from US DOT.