PUERTO RICO CONSERVATORY OF MUSIC CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

FINANCIAL STATEMENTS WITH AUDITORS' REPORT

YEARS ENDED JUNE 30, 2009 AND 2008

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(A Component Unit of the Commonwealth of Puerto Rico)

YEARS ENDED JUNE 30, 2009 AND 2008

CONTENTS

Horwath Vélez & Co. PSC
Certified Public Accountants / Business Advisors

Centro Internacional de Mercadeo
100 Carr 165, Suite 410
Guaynabo, PR 00968-8051
Telephone: (787) 625-1800
Fax: (787) 625-1812
Web Site www.horwathpr.com

INDEPENDENT AUDITORS' REPORT

Board of Directors
Puerto Rico Conservatory of Music Corporation
San Juan, Puerto Rico

We have audited the accompanying financial statements of the business-type activities of **Puerto Rico Conservatory of Music Corporation** (a component unit of the Commonwealth of Puerto Rico) as of and for the years ended June 30, 2009 and 2008, which collectively comprise the Corporation's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of **Puerto Rico Conservatory of Music Corporation (a component unit of the Commonwealth of Puerto Rico)** as of June 30, 2009 and 2008, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis included on pages 2 through 10, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

September 29, 2009

Horwath Vélez & Co. PSC

Stamp number 2460533 was affixed to the original of this report.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management of the Corporation provides this Management's Discussion and Analysis (MD&A) for the readers of the Corporation's basic financial statements. This narrative overview and analysis of the financial activities of the Corporation for the fiscal years ended June 30, 2009, and intended to provide an easily readable explanation of the information provided in the attached basic financial statements. We encourage readers to consider this information with the Corporation's basic financial statements that follow.

SUMMARY OF LEGAL BASES:

Law No. 35 of June 12, 1959 created the Puerto Rico Conservatory of Music Corporation. Years later, Law No. 77 of May 30, 1980 created the Corporation like a subdivision of the Administración para el Fomento de Artes y Cultura. Through Law No. 2 of July 31, 1985 the Corporation became an affiliate of Corporación de las Artes Musicales. Finally, in 1995 the Conservatory became an independent organization by virtue of Law No. 141 of August 9, 1995.

MISSION:

The Puerto Rico Conservatory of Music Corporation is a specialized university institution, with excellence in the total formation of professional musicians, allowing them to continue an artistic career in music and become cultural leaders of our society. Also it preserves and enrich the musical traditions of Puerto Rico, and the western civilization.

ORGANIZATIONAL STRUCTURE:

The Puerto Rico Conservatory of Music Corporation is governed by a Board of Directors composed by seven members appointed by the Governor. The Directors select between its members the position of president, vice-president and secretary. Also they appoint the Chancellor after consultation with the faculty, students, non-educational personnel and the Academic Senate. The Chancellor is the principal executive and the maximum administrative and academic authority of the Corporation. The organizational structure includes the following areas:

- Deanship of Academic Subjects
- Deanship of Student Subjects
- Deanship of Administrative Subjects and Finances
- Deanship of Military preparatory school
- Office of Development, Activities and Concerts
- Office of Registrar
- Library “Amaury Veray “
- Office of Human Resources
- Office of the Chancellor

PROGRAMMATIC STRUCTURE:

Development of the Musical Talent Program

Program Description:

The principal purpose is the formation of professional musicians in areas such as the interpretation of instruments and songs, as well as the composition and the formation of music teachers for the schools of Puerto Rico. Also, it offers continuous education to professional musicians, certification of teachers to obtain continuing education in the public education system and several training programs to obtain the license of teachers in the system of public education. Also, several training programs are offered to develop the musical talent of children in pre-scholastic and the scholastic age (young and adult).

Objectives:

- To develop professional musicians to maintain a rich and active musical life in the country.
- To form the music teachers for the schools of Puerto Rico
- Expand and develop the knowledge of the professional musicians of Puerto Rico.
- To provide to the Puerto Rican community informatives programs in music, with access to all the Island residents, allow children, young and adults to discover and develop their musical and artistic talent to the maximum.

STATISTICAL DATA:

The general index of retention of the Conservatory is of approximately 90%. The institution retained 90% of new entrance students and 75% of the withdrawn ones are working in areas related to their music studies or study graduated courses in music outside of Puerto Rico.

Statistical Data	2007	2008	2009
Concerts and activities	275	300	300
Non-college students enrollment	1,300	1,300	1,300
College students enrollment	380	385	410
Attending public to activities	18,000	19000	19,000

STUDENTS:

The 89% of the students are high school graduates who want to become professionals musicians. An 11% are transfers from other universities. The Conservatory serves to a total of 46 towns or 59% of the total of municipalities. The general composition of the students indicate that: 53% come from the metropolitan area and a 47% from the rest of the Island. The university program has an enrollment of 410 students at June 30, 2009. The non-college students are basically children from infants to scholastic age. Young people and adults of all ages that wish to discover and develop their musical talent amount to 1,300 students. The training programs that the Conservatory offers, the annual students amount to approximately 1,600 students. The Conservatory, also, offers a varied billboard of more than 250 activities and concerts annually with an attendance of approximately 18,000 people.

We encourage readers to consider the information presented here in conjunction with the Corporation's basic financial statements (pages 11-14) and the notes to the financial statements (pages 15-29).

USING THIS ANNUAL REPORT:

This annual report is presented in a format consistent with the presentation requirements of the Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*, as amended by GASB Statements No. 37 and 38, which expands the applicability of Statement No.34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* effective for fiscal years beginning July 1, 2001. Previously, public colleges and universities had their own financial reporting model. The new reporting model should make annual reports easier to understand and be more useful to the people who use the information to make decisions: legislators, investors, creditors and the general public.

The most notable feature of the new model is the requirement for government-wide financial statements. The focus of these financial statements will be on the government as a whole rather than on individual funds. These statements are prepared on the full accrual basis of accounting and will have the look and feel of corporate financial statements. Users of the statements will be able to see the cost of providing services, and how government finances its programs, and understand the extent in which government has invested in capital assets. Other requirements are: the presentation of capital assets infrastructure, reporting cash flows from operations, changed from indirect to direct method and Management's Discussion and Analysis is required as supplementary information.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS:

The Corporation financial statements consist of the three basic financial statements and notes that provide information on the accounting alternative used, and explanatory information and detail on certain financial elements. The three basic financial statements are the Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows.

The Statement of Net Assets presents the information on the Corporation's assets, liabilities and net assets, all as of the end of the reporting period. Net assets represents the difference between assets and liabilities, and is detailed into classifications that help readers understand the constraints that the Corporation must consider in making decisions on expending assets. Over time, changes in net assets can help in understanding whether the financial condition of the Corporation is improving or deteriorating.

The Statement of Revenues, Expenses and Changes in Net Assets presents information on the changes in net assets during the year. All changes in net assets are reported as soon as the underlying event takes places, regardless of the timing of the related cash flow. Thus, revenues and expenses are recorded for some items that will results in cash flows in future fiscal years.

The Statement of Cash Flows presents information on sources and uses of cash during the year. This statement details the changes in cash and cash equivalents from the amounts reported at the end of the preceding year, to the amounts reported in the Statement of Net Assets as of the end of the current year. Sources and uses are organized into operating activities, noncapital financial activities, capital and related financing activities, and investing activities.

The notes to financial statements provide additional information that is essential to the full understanding of the data provided in the Corporation's financial statements.

FINANCIAL HIGHLIGHTS AND ANALYSIS OF SIGNIFICANT VARIANCES:

As of June 30, 2009 and 2008, the Corporation's financial health remains strong, with assets exceeding liabilities by $61,526,882 and $55,035,902, respectively, show on the Statements of Net assets as total net assets . For the year ended June 30, 2008, total net assets increased by $6,490,980. Net assets invested in capital assets, net of related debt, increased by $44,409,131, while unrestricted net assets (deficit) decreased $145,643, and restricted net asset categories decreased by $38,063,794. Unrestricted net assets represents the portion of assets, after taking into account liabilities, which can be used to meet ongoing obligation and fund new initiatives. The decrease in unrestricted net assets (deficit) for the year ended June 30, 2009 is attributable to continuing Corporation's efforts to limit expenditures and increases in tuition rates and other students charges during the year.

The table below presents summary-level information of the Corporation's assets, liabilities, and net assets as of June 30, 2009 and 2008.

FINANCIAL ANALYSIS:

CONDENSED STATEMENTS OF NET ASSETS

	2009	2008
Current assets	$ 4,117,098	$ 8,822,856
Capital assets	61,109,780	53,067,107
Other assets	2,291,681	2,346,928
Total assets	67,518,559	64,236,891
Current liabilities	3,299,770	5,520,631
Non-current liabilities	910,517	944,305
Total liabilities	4,210,287	6,464,936
Net assets:		
Investment in capital assets, net of related debt	51,164,092	6,754,961
Restricted	10,954,126	49,017,920
Unrestricted	(591,336)	(736,979)
Total net assets	$ 61,526,882	$ 55,035,902

The table below presents summary-level information on revenues, expenses, and other changes in the Corporation's net assets for the years ended June 30, 2009 and 2008.

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	2009	2008
Operating revenues	$ 2,691,646	$ 2,417,376
Operating expenses	8,811,138	7,236,522
Net operating loss	(6,119,492)	(4,819,146)
Non-operating revenues	12,584,528	15,633,211
Income before capital contributions	6,465,036	10,814,065
Capital contributions	25,944	78,367
Change in net assets	6,490,980	10,892,432
Net assets, beginning	55,035,902	44,143,470
Net assets, ending	$ 61,526,882	$ 55,035,902

FINANCIAL HIGHLIGHTS AND ANALYSIS OF SIGNIFICANT VARIANCES(CONTINUED):

SIGNIFICANT VARIANCES:

- The assets of the Corporation exceeded its liabilities by $55,035,902 and $44,143,470 during 2009 and 2008, respectively. However, approximately 98% of the Corporation's net assets, reflects its investment in capital assets (eg., land, building, equipment, musical instruments, etc.), that are not available for future spending. Scholarship restricted endowment for 2009 and 2008 amounted to $985,864 and $$959,520 respectively. These represent resources that are subject to external restrictions on how they may be used. Remaining balance of unrestricted net assets is a deficit of $591,336 and $736,979 for fiscal years ended June 30, 2009 and 2008, respectively.

- The Puerto Rico Department of Labor approved a proposal in the amount of $75,000, to cover the payroll expense for the faculty and consulting services. The legislative appropriations for the fiscal year ended June 30, 2009 amounted $5,552,000. Considering that approximately $8,811,138 are operating expenses, the Corporation is increasing its tuition fees and fund raising activities to improve its operations. Activities and concerts were made during the year; receiving international artists for forums, festivals and concerts, among others.

- The Corporation is in the process of remodeling a building donated from the Commonwealth of Puerto Rico that will be used as its operating facilities. On January 8, 2004, a new law (No. 142) was approved by the Commonwealth of Puerto Rico in order to complete this project. During the last five years (2004-2009), the Corporation should receive approximately $32 millions to complete the "Nueva Sede" project. During fiscal years ended June 30, 2009 and 2008, the Corporation received approximately $10,973,466 and $16,674,060 respectively, to make payments to contractors. This amount was deducted from the prior year accounts receivable balance and capitalized as construction in progress. The stabilization process and the external remodeling stages was finished and the parking lot construction called "Plaza la Laguna" was completed. The Corporation maintains a retainage payable due to the contractors of approximately $1,255,597. As a result, an increase in non-current liabilities is noted in the accompanying comparative financial analysis.

- The decrease in current liabilities of approximately 40% is basically due to the construction payments made to contractors.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SIGNIFICANT VARIANCES (CONTINUED):

- Tuition and fees increased approximately 14.5% over prior year. Results are related to the increase in head counts, enrollments and academic load.

- The increase in operating revenues of $274,270 is basically due to an increase in tuition and fees income.

- Operating expenses increased, in overall, approximately 21.76%. The Corporation received from the government $846,000 more than the prior year. However, the increase was basically due to the Institution is managed operating costs of the old premises in Roosevelt Avenue and new facilities in Miramar, Puerto Rico since December 2008.

SIGNIFICANT OBJECTIVES REACHED:

The fiscal year ended June 30, 2009 was of very good for the Corporation. Achieving our strategic plan and annual work plan. The following list were the main achievements:

- The Corporation successfully completed the process of reaccreditation by the three accrediting agencies: Middle States, El Consejo de Educación Superior and the National Association of Schools of Music; where the three agencies jointly accredited the Institution. The evaluation of these agencies was of excellence for the Institution, being that they were very much impressed with the Institution's labor and its product.

- The restoration of the existing Historical Building and the Parking lot was completed.

- The construction of the Academic Building started on January 2008. As of June 30, 2009, the building has been completed in approximately 21%.

- The Conservatory obtained marks of Excellence in its setup program of teachers, according to results obtained by our students in the test of Certification of Teachers which administers the College Board. Of all the institutions of education in Puerto Rico, the Conservatory was one of four institutions that a ranking with the qualification of Excellent was obtained.

- In June of 2009, the Corporation graduated the third class of its new Masters Degree in Music Education Program; without doubts a great institutional event.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

SIGNIFICANT OBJECTIVES REACHED (CONTINUED):

- The Corporation led an effort to create a large cultural alliance of fifteen arts institutions in the Santurce District. This new alliance, ArteSanturce, promote new collaborative art and revitalize the Santurce District.

- The enrollment of the Conservatory continues to grow in the university programs, exceeding 410 students.

- The Corporation moved to the Historic Building facilities during December 2008. The cost of this building and the parking amounted to approximately $44,090,000.

- The international enrollment of the Conservatory has increased, attracting numerous students from Latin America, including: México, Costa Rica, Panamá, Perú, Venezuela, Sto. Domingo, Brazil, Chile. During the past year the international enrollment increased 50%.

- Also, the new program of Jazz and Caribbean Music is increasing its enrollment and has received an ample welcome, in general, from the musical community. The innovation of this program represents the recognition of the quality of our faculty.

- The project "Despertar Musical", pre-school curriculum, created by the Conservatory of Music was implemented with great success in the Municipality of Caguas and in all Head Start Centers, participating a total of 1500 children and 125 teachers. This project has been supported by the Angel Ramos Foundation and will enter the year 2008-09 in its third year of successful implementation. The implementation of "Despertar Musical" will mean for thousands of children the first time they have a formal encounter with music.

- A fund raising campaign was made for the New Sede of the Conservatory in Miramar, Puerto Rico. The total funds collected amounted to approximately $2,780,000. All of these funds are considered conditional promises to give from donors. The donors restricted the use to acquire educational equipment for the classrooms in accordance with actual tecnology as well as to acquire musical instruments such the new Steinway Pianos collection.

- We obtained by donations of time, services and advertising the creation and launching of the campaign "Tú eres instrumental", a new project of the Conservatory.

The fiscal year ended June 30, 2009 has been one of great success and growth in existing and new programs, as well as the sprouting of the Conservatory as institution leader in Latin America. In addition, the Corporation has solidified, its presence and recognition in the United States. We project that our goal to internationalize the Corporation, in route to the re-sizing that will provide our new facilities this year, have become more than evident in the achievements that we have previously enumerated.

REQUEST FOR INFORMATION:

This financial report is designed to provide a general overview of the corporation's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chancellor's Office, Puerto Rico Conservatory of Music Corporation, Soldado Rafael Lamar Street #350, San Juan, Puerto Rico 00918-2199.

PUERTO RICO CONSERVATORY OF MUSIC CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENTS OF NET ASSETS - JUNE 30, 2009 AND 2008

ASSETS

	2009	2008
Current assets:		
Cash and cash equivalents	$ 252,157	$ 271,229
Accounts receivable:		
Commonwealth of Puerto Rico	3,554,427	8,388,630
Government agencies	220,217	88,535
Prepaid expenses	28,998	39,326
Other, net of allowance for doubtful accounts of $233,964 for 2009 and $210,992 for 2008	61,299	35,136
Total current assets	4,117,098	8,822,856
Non-current assets:		
Restricted cash and cash equivalents	2,291,681	2,346,928
Capital assets, net of accumulated depreciation	61,109,780	53,067,107
Total non-current assets	63,401,461	55,414,035
Total assets	67,518,559	64,236,891
LIABILITIES		
Current liabilities:		
Accounts payable	1,526,104	4,330,988
Current portion of line-of-credit	505,834	-
Compensated absences	130,720	167,128
Accrued expenses	444,825	316,467
Deferred income	692,287	706,048
Total current liabilities	3,299,770	5,520,631
Non-current liabilities:		
Compensated absences	930,462	750,602
Retainage payable	1,255,597	2,929,756
Line-of credit	505,848	-
Total non-current liabilities	2,691,907	3,680,358
Total liabilities	5,991,677	9,200,989
NET ASSETS		
Investment in capital assets, net of related debt	51,164,092	6,754,961
Restricted for:		
Construction of new facilities	9,968,262	48,058,000
Scholarship restricted endowment fund	985,864	959,920
Unrestricted (deficit)	(591,336)	(736,979)
Total net assets	$ 61,526,882	$ 55,035,902

See notes to financial statements.

PUERTO RICO CONSERVATORY OF MUSIC CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
Operating revenues:		
Tuition and fees (net of scholarship allowance of $107,224 in 2009 and $85,524 in 2008)	$ 2,157,722	$ 1,883,932
Local and private sponsored programs	409,152	408,885
Rent	2,055	30,007
Other	122,717	94,552
Total operating revenues	2,691,646	2,417,376
Operating expenses:		
Salaries and fringe benefits	3,128,243	2,794,885
Faculty professional and consulting services	2,276,117	2,217,698
Professional and consulting services	267,687	226,147
Depreciation and amortization	740,008	226,023
Rent	191,328	228,880
Utilities	456,817	376,368
Repairs and maintenance	263,962	172,038
Scholarships	80,499	117,690
Bad debts	22,416	51,729
General and administrative	1,384,061	825,064
Total operating expenses	8,811,138	7,236,522
Operating loss	(6,119,492)	(4,819,146)
Non-operating revenues (expenses):		
Legislative appropriations	5,552,000	4,706,000
Special appropriations	175,000	175,000
Construction fund	6,000,000	10,675,000
Interest income	16,781	13,807
Gifts and grants	860,509	63,404
Interest on capital asset-related debt	(19,762)	-
Total non-operating revenues	12,584,528	15,633,211
Income before capital contributions	6,465,036	10,814,065
Capital contributions:		
Term endowments, total capital contributions	25,944	78,367
Increase in net assets	6,490,980	10,892,432
Net assets, beginning of year	55,035,902	44,143,470
Net assets, end of year	$ 61,526,882	$ 55,035,902

See notes to financial statements.

PUERTO RICO CONSERVATORY OF MUSIC CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENTS OF CASH FLOWS

YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
Cash flows from operating activities:		
Tuition and fees	$ 2,133,594	$ 1,930,383
Local and private sponsored programs	458,244	292,606
Employees and related fringe benefits	(5,255,085)	(5,012,583)
Payments to suppliers	(3,342,110)	(4,419,031)
Other receipts	86,449	67,818
Net cash used in operating activities	(5,918,908)	(7,140,807)
Cash flows from non-capital financing activities:		
Legislative appropriations	5,552,000	4,635,000
Special appropriations	8,353,130	16,674,060
Capital gifts and grants	919,741	141,771
Net cash provided by non-capital financing activities	14,824,871	21,450,831
Cash flows from capital and related financing activities:		
Payments for capital assets	(7,774,802)	(14,309,889)
Advances from line-of-credit	991,920	-
Net cash used from capital and related financing activities	(6,782,882)	(14,309,889)
Cash flows from investing activities,		
Interest income	16,781	13,807
Cash flows from financing activities,		
Retainage paid to contractor	(2,158,934)	-
Net increase (decrease) in cash and cash equivalents	(19,072)	13,942
Cash and cash equivalents at beginning of year	271,229	257,287
Cash and cash equivalents at end of year	$ 252,157	$ 271,229

Continued.

PUERTO RICO CONSERVATORY OF MUSIC CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENTS OF CASH FLOWS (CONTINUED)

YEARS ENDED JUNE 30, 2009 AND 2008

	2009	2008
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$(6,119,492)	$(4,819,146)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense	740,008	226,023
Bad debts	22,416	51,729
Change in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	(145,317)	(95,150)
Others	10,328	(9,412)
Increase (decrease) in:		
Accounts payable	(684,900)	(2,505,259)
Accrued expenses	271,810	(59,910)
Deferred revenues	(13,761)	70,318
Total adjustments	200,584	(2,321,661)
Net cash used in operating activities	$(5,918,908)	$(7,140,807)

Non-cash investing, capital, and financing activities

	2009	2008
Construction fund	$ 3,101,289	$ 14,648,256
Non-cash additions	$ 1,007,880	$ 3,437,005
Special appropriations not received	$ 453,138	$ 198,913

See notes to financial statements.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization:

The Puerto Rico Conservatory of Music Corporation (the Corporation) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth), and created by Act No. 77, as amended, (the Act) of the Legislature of the Commonwealth on September 7, 1993. On August 9, 1995, an amendment to the Act was approved in order to grant fiscal and operational autonomy to the Corporation effective July 1,1995.

The Corporation is governed by a seven-member board appointed by the Governor, with the consents of the Senate. The Corporation is responsible for providing the Puerto Rico community, and especially its youths, with the required facilities to educate and perfect their musical skills, including secondary educational program for developing musical arts. It prepares the artistic element that nourishes the Puerto Rico Symphony Orchestra and other musical organizations, and coordinates the governmental efforts to interested industries, private enterprise, and particular citizens. The Commonwealth provides financial support to the Corporation through legislative appropriations.

Measurement Focus and Basis of Accounting:

For financial reporting purposes, the Corporation is considered a special purposes governmental agency engaged only in business-types activities, as defined by the GASB 34. Accordingly, the Corporation's financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under accrual basis, revenues are recognized when earned, and expenses are recorded when the liability was incurred regardless of the timing of related cash flow. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

Application of Accounting Standards:

The Corporation has the option under GASB No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB pronouncements conflict with GASB pronouncements. The Corporation has elected to not apply FASB pronouncements issued after November 30, 1989.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Classification of Revenues and Expenses:

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Corporation are tuition and fees, rent, federal grants, local and private sponsored programs and other. Operating expenses for proprietary funds includes mainly, salaries, faculty professional and consulting services, and other general and administrative operating expenses. Certain significant revenue streams relied upon for operations are recorded as non-operating revenues as defined by GASB No. 34, including appropriations, investment income and gifts. Restricted and unrestricted resources are spent and tracked at the discretion of the Corporation within the guidelines of donor restricted, if any.

Financial Independence:

The Corporation is responsible for its debts and is entitled to its surplus. No other governmental agency can receive the benefits nor can impose financial strain on the Corporation.

Designation of Management:

The Board of Directors appoints a Chancellor. The Chancellor selects the other members of management. The powers and functions of management reside within the legal limits of the Corporation, and they are responsible to the Board of Directors.

Capacity to Manage Operations:

The Corporation has the legal capacity to make significant decisions in the management of its operations. This legal capacity includes, but not limited, to the control of the assets, which include facilities and properties, make short-term loans, and contract and develop programs.

Use of Estimates in the Preparation of Financial Statements:

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 related disclosures at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Concentration of credit risk:

The Corporation maintains cash and cash equivalents in deposit accounts with high credit financial institutions. The laws of the Commonwealth of Puerto Rico require that public funds deposited in commercial banks be collateralized when funds exceed the amount insured by the Federal Government. The securities pledged by the banks as collateral for those deposits are under the custody of the Secretary of the Treasury in the name of the Commonwealth of Puerto Rico.

Cash and Cash Equivalents:

Represent petty cash, checking and savings accounts, and certificates of deposit with original maturities of less than three months. At June 30, 2009 and 2008, $2,291,681 and $2,346,928, respectively, were restricted for the realization of permanent work and betterments.

Capital Assets:

Property, plant, equipment, and books and materials are stated at historical cost when purchased or at estimated fair value when donated. Costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Renovations to building and other assets that significantly increase the value or extend the useful life of the assets capitalized. Depreciation is computed on a straight-line basis over the following estimated useful lives:

Assets	Years
Building	40
Library	40
Furniture and equipment	15
Musical instruments	15
Leasehold improvements	7
Motor vehicles	5
Software	5

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Capital assets (continued):

Classification of Net Assets:

The Corporation's net assets are classified as follow:

a. **Investment in capital assets, net of related debt** - Investment in capital assets, net of related debt - Represents the Corporation's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

b. **Restricted net assets** - Consists of net assets with constraints placed on the use either by 1) external groups such as grantors, contributors or laws and regulations of other governments, or 2) law through constitutional provisions or enabling legislation.

c. **Unrestricted net assets** - Net assets whose use by the Institution is not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may be limited by contractual agreements with outside parties.

The Corporation's policy is to first use restricted net assets prior to the use of unrestricted net assets when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. Restricted assets include assets that are legally restricted as to their use. The primary restricted assets are related to scholarship endowment fund that was fully explained on Note 6.

Compensated Absences:

The vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the balance sheet date. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Compensated Absences (continued):

The vacation policy of the Corporation generally provides for the accumulation of 2.5 days per month. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. Employees accumulate sick leave generally at rate of 1.5 days per month up to a maximum of 90 days

Accrued vacations and sick leave benefits as of June 30, 2009 and 2008 amounted to $1,061,182 and $917,730, respectively.

Scholarship Allowances and Student Financial Aid:

Student tuition and fees, and certain other revenues from students, are expected net of scholarship discounts and allowances in the statements of revenues, expenses and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the Corporation and the amount that is paid by students and/or third parties making payments on the students' behalf.

Certain governmental grants, such as Pell grants and other federal, state or nongovernmental programs, are recorded as operating revenue in the Corporation's financial statements.

Legislative Grants:

The Corporation receives annually legislative grants from the Government of the Commonwealth of Puerto Rico. These grants are for the operations of the Corporation and are recognized when granted. The legislative grants for any specific activity not used in the fiscal year are credited to a deferred income and credited to income when used.

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

Participation on Excise Taxes from Public Shows:

Represents funds distributed by the Commonwealth of Puerto Rico, through the Treasury Department, in accordance with Law No. 120 of October 31, 1994 "Codigo de Rentas Internas de 1994", as amended. According to this law, every three months, the Treasury Department transfers 10% of the total excise taxes assessed by the Commonwealth of Puerto Rico on all public shows, which subsequently are distributed for cultural and artistic programs. The 34% of this fund is distributed to the Corporación del Conservatorio de Música de Puerto Rico and the remaining 66% to the Orquesta Sinfónica de Puerto Rico and Corporación de las Artes-Escénico Musicales de Puerto Rico-Festival Casals. The funds are recognized as revenue by the recipient when the distribution is made.

Gifts and Pledges:

Pledges of financial supports from organizations and individuals representing and unconditional promise to give are recognized in the financial statements once all eligibility requirements, including time requirements, have been met. In absence of such promise, revenue is recognized when the gift is received. Endowment pledges generally do no meet eligibility requirements, as defined by GABS Statement No. 33, Accounting and Financial Reporting for No exchange Transactions, and are not recorded as assets until the related gift has been received. Unconditional promises that are expected to be collected in the future years are recorded at the present value of the estimated future cash flows.

Accounting for Pension:

The Corporation accounts for pension under the provisions of GASB Statement No. 27, Accounting for Pensions by State and Local Government Employers, as amended by GASB No. 50, Pension Disclosures. This Statement established standards for measurement, recognition and display of pension expense and related liabilities in financial statements of state and local governmental employers.

Reclassifications:

Certain 2008 balances have been reclassified to conform to the current year presentation.

2. CAPITAL ASSETS:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets not being depreciated:				
Land	$ 5,156,500	$ -	$ -	$ 5,156,500
Construction in progress	46,312,146	-	37,358,377	8,953,769
	51,468,646	-	37,358,377	14,110,269
Capital assets being depreciated:				
Building	-	44,089,738	-	44,089,738
Library	375,670	-	-	375,670
Furniture and equipment	1,373,979	982,327	-	2,356,306
Leasehold improvements	1,330,579	-	-	1,330,579
Musical instruments	694,393	1,045,349	-	1,739,742
Software's	193,563	23,644	-	217,207
Motor vehicles	17,500	-	-	17,500
Total capital assets being depreciated	3,985,684	46,141,058	-	50,126,742
Less accumulated depreciation for:				
Building	-	551,122	-	551,122
Library	160,683	4,719	-	165,402
Furniture and equipment	573,932	101,720	-	675,652
Leasehold improvements	1,232,650	33,742	-	1,266,392
Musical instruments	246,977	30,941	-	277,918
Software's	164,231	14,264	-	178,495
Motor vehicles	8,750	3,500	-	12,250
Total accumulated depreciation	2,387,223	740,008	-	3,127,231
Business-type activities capital assets, net	$ 53,067,107	$ 45,401,050	$ 37,358,377	$ 61,109,780

3. RETIREMENT SYSTEM:

The Employees' Retirement System of the Commonwealth and its instrumentalities (the Retirement System) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth. All regular employees of the Corporation under age 55 at the date of employment become members of the Retirement System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits. Disability benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits are vested after ten years of plan participation.

Members who have attained 55 years of age and have completed at least 25 years of creditable service or members who have attained 58 years of age and have completed at least 10 years of creditable service, are entitled to an annual benefit, payable monthly for life.

The amount of the annuity shall be one and one-half percent of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than $280 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive 65% of the average compensation, as defined, otherwise they will receive 75% of the average compensation. Disability benefits are available to member for occupational and non-occupational disability. However, for non-occupational disability a member must have at least 10 years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

Commonwealth legislation requires employees to contribute 5.775% for the first $550 of their monthly gross salary up to $6,600 and 8.275% for the salary in excess of $550 for employees hired on or before April 1, 1990. The Corporation's contributions are 9.275% of gross salary. For the years ended June 30, 2009, 2008 and 2007, the payroll covered by the System amounted to approximately $2,614,039, $2,439,800 and $2,596,600, respectively.

3. RETIREMENT SYSTEM (CONTINUED):

The pension expense for the years ended June 30, 2009, 2008 and 2007 amounted to approximately $ 272,686, $226,369 and $240,000, respectively.

The financial statements and required supplementary information for the Retirement System is available by writing to Administrator-Employees' Retirement system of the Commonwealth of Puerto Rico, PO Box 42003, Minillas Station, Santurce, PR 00940.

On September 24, 1999, and amendment to Act No. 447 of May 15, 1951, which created the System, was enacted with the purpose of establishing a new pension program (System 2000).

System 2000 became effective on January 1, 2001. Employees participating in the current system as of December 31, 1999, elected either to stay in the defined benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, were only allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets which will be invested by the System, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which 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%) will be 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 System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000. The employers' contribution (9.275% of the employee's salary) will be used to fund the deficiency of the defined benefit plan.

System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

3. RETIREMENT SYSTEM (CONTINUED):

The amount of the total pension benefits obligation is based on a standardized measurement established by general accepted accounting principles that, with some exceptions, must be used by a public employee retirement system. The standardized measurement is the actuarial present value of credited projected benefits. This pension valuation method reflects the present value of estimated pension benefits that will be paid in future years as a result of employee services performed to date and is adjusted for the effects of projected salary increases. The significant actuarial assumptions used to determine the standardized measure of the pension benefits obligation are summarized below:

- The most recent actuarial valuation is as of June 30, 2007:

• Interest rate	7.5% a year
• Salary increases	3% a year
• Pre-retirement mortality	RP-2000 Employee mortality rate for males and females projected on a generational basis using Scale AA
• Pre-retirement Health Mortality	Gender-specific mortality rate were developed based on a study of plan experience from 2003-2007
• Pre-retirement Disabled Mortality	RP-2000 Disabled Annuitant Mortality rate without projection
• Termination	Annual rate of termination 2.0%. Current terminated members with a vested benefit are assumed to retire at the age of 58 by Act 447 and at the age of 65 by Act 1
• Disability	75% of Third Railroad Retirement Table Rates
• Retirement	Rates of retirement vary by employment category, Act, age and years of Creditable Service

3. RETIREMENT SYSTEM (CONTINUED):

• Marriage	50% of participants assumed to be married with wives assumed to be four years younger than husbands
• Number of employees Electing Higher Contributions	15% of retiring employees assumed to pay retroactive contributions at retirement

The required and realized contribution by the employees and the employer for the years ended June 30, 2009 is as follows:

	2009	2008	2007
Required and realized contribution by the employees	$ 215,929	$ 202,312	$ 215,275
% that represents the total of payroll covered	8.29%	8.29%	8.26%
Required and realized contribution by the employer	$ 242,452	$ 226,297	$ 240,000
% that represents the total of payroll covered	9.27%	9.27%	9.27%

4. NON-CURRENT LIABILITIES:

Changes in noncurrent liabilities for the year ended June 30, 2009 and 2008, are as follows:

Year 2009

	Beginning Balance	Additions	Deductions	Ending Balance	Due within one year
Accrued personnel costs	$ 917,730	$ 274,172	$ 130,720	$ 1,061,182	$ 130,720
Retainage payable	$2,929,756	$ 484,775	$2,158,934	$ 1,255,597	$ 610,000
Line-of-credit	$ -	$1,009,682	$ -	$ 1,009,682	$ 505,834

Year 2008	Beginning Balance	Additions	Deductions	Ending Balance	Due within one year
Accrued personnel costs	$ 917,730	$ 167,128	$ 167,128	$ 917,730	$ 167,128
Retainage payable	$1,065,439	$1,864,317	$ -	$2,929,756	$2,158,934

5. SCHOLARSHIP RESTRICTED ENDOWMENT FUND:

The scholarship restricted endowment fund, to be invested for twenty years, was established in 2002. The awards made by private foundations were matched dollar by dollar by an equal amount provided by the Department of Education, Title V. The Corporation can use only 50% of the endowment funds income. After twenty (20) years, it may use all of the endowment fund income for whatever educational purposes it defines.

5. SCHOLARSHIP RESTRICTED ENDOWMENT FUND (CONTINUED):

The scholarship restricted endowment fund consists of awards received to be matched with federal funds as follows:

	2009	2008
Angel Ramos	$ 200,000	$ 200,000
Fundación Banco Popular	300,000	300,000
Donations made by individuals	13,495	13,495
	513,495	513,495
Matching federal funds, Title V	363,495	363,495
Accumulated interest from endowment investments	168,634	142,690
Scholarships awarded	(59,760)	(59,760)
Total	$ 985,864	$ 959,920

6. LINE-OF-CREDIT:

The Corporation has available a revolving line of credit with Banco Gubernamental de Fomento de Puerto Rico and the maximum amount that may be outstanding under the agreement is $1,360,000 through June 30, 2017. Borrowings under the line of credit bear interest at LIBOR plus 1.25% and will be payable at the end of the agreement. The outstanding balance of the line of credit at June 30, 2009 was $991,920. As part of the line of credit agreement, the Corporation has conditional promises from donors amounting to approximately $1,987,000 which should be received and used to pay off the line-of-credit until its maturity date, June 30, 2017.

7. CONDITIONAL PROMISES TO GIVE:

During the years 2008 and 2009 the Corporation has received conditional promises to give as follows:

Promises conditioned for the "Centro de Recursos de Aprendizaje" Angel Ramos Foundation	$ 583,336
Promise conditioned to be used for "Centro Empresarial Músicos Culturarte, Inc. (CEMCA)	250,000
Promises conditioned for the acquisition of musical instruments, technological equipment, furniture and fixtures for the New Sede Building in Miramar, PR	$ 1,950,025
	2,783,361
Less conditional promises already received	1,233,361
Conditional promises still pending to be received	$ 1,550,000

8. COMMITMENTS AND CONTINGENCIES:

Lease Agreements:

The Corporation leases office facilities for various terms under non-cancelable operating lease agreements. The leases expire at various dates through 2011 and provide for renewal options. The leases provide for increases in future minimum rental payments. Also, the agreements require the Corporation pays executory costs such as insurance, repairs and maintenance, among others.

The following is a schedule by year of future minimum rental payments required under the operating lease agreements:

Year ending June 30,	Minimum future rental payments
2010	$ 179,750
2011	164,150
	$ 343,900

8. COMMITMENTS AND CONTINGENCIES (CONTINUED):

Lease Agreements (continued):

Rental expense for operating leases during 2009 and 2008 amounted to approximately \$111,839 and \$161,969, respectively.

The rent agreement with Puerto Rico Development Company ended in June 30, 2008. The Corporation paid rent in a monthly basis until December 2008 when they moved to the new facilities in Miramar, Puerto Rico.

The Corporation is constructing a new academic building scheduled to be completed in 2011. As of June 30, 2009, the Corporation incurred and capitalized in Construction in Progress \$8,954,000. During 2008, the Corporation entered into various construction agreements amounting to approximately \$29,500,000; of which \$2,524,000 and \$2,002,000 have been paid during 2009 and 2008, respectively.

Federal Assistance Programs:

Amounts received and expended by the Corporation under various federal programs are subject to audit by governmental agencies. In the opinion of management, audit adjustments, if any, will not have a significant effect on the statement of net assets of the Corporation.

The Corporation participates in a number of federal financial assistances programs. These programs are subject to audits in accordance with the provisions of OMB Circular A-133, Audits of States, Local Governments and compliance audits by grantor agencies. Managements believes that it has complied with all aspects of grant provisions and the results of adjustments, if any, relating to such audit would not have a material impact on the programs and financial statements.

BASIC FINANCIAL STATEMENTS