



Secretaría

LCDA. TANIA BARBAROSSA ORTIZ

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INICIALES

REFERIDO A:

COMISIONES PERMANENTES

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- JURIDICA, SEGURIDAD Y VETERANOS
- SALUD Y NUTRICIÓN
- EDUCACIÓN, FORMACIÓN Y DESARROLLO DEL INDIVIDUO
- ASUNTOS DE LA MUJER
- INFRAESTRUCTURA, DESARROLLO URBANO
Y TRANSPORTACIÓN
- AGRICULTURA, SEGURIDAD ALIMENTARIA
Y SUSTENTABILIDAD DE LA MONTAÑA
- RECURSOS NATURALES, AMBIENTALES
Y ASUNTOS ENERGÉTICOS
- COOPERATIVISMO, PEQUEÑAS Y MEDIANAS EMPRESAS
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- DERECHOS CIVILES, PARTICIPACIÓN CIUDADANA
Y ECONOMÍA SOCIAL
- AUTONOMÍA MUNICIPAL, DESCENTRALIZACIÓN
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- BANCA, SEGUROS Y TELECOMUNICACIONES
- VIVIENDA Y COMUNIDADES SOSTENIBLES
- ÉTICA E INTEGRIDAD LEGISLATIVA
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Y ALIANZAS PÚBLICO-PRIVADAS
- REGLAS, CALENDARIO Y ASUNTOS INTERNOS

2172

LLM&D, PSC
165 Ponce de León Ave.,
Second Floor
San Juan, Puerto Rico
00917-1233

Puerto Rico Water Pollution Control Revolving Fund

Basic Financial Statements
and
Required Supplementary Information
June 30, 2013

(With Independent Auditors' Report Thereon)

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PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

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LLM&D, PSC
165 Ponce de León Ave.,
Second Floor
San Juan, Puerto Rico
00917-1233

Independent Auditors' Report

To the Board of Directors of
Puerto Rico Water Pollution
Control Revolving Fund

Report on the Financial Statements

We have audited the accompanying statement of net position of the Puerto Rico Water Pollution Control Revolving Fund (the Revolving Fund") as of June 30, 2013 and the statements of revenue, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Revolving Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these basic financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these basic financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Revolving Fund's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Revolving Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Revolving Fund, as of June 30, 2013, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in note 1, in 2013, the Revolving Fund adopted Governmental Accounting Standards Board (“GASB”) Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis on pages 3 through 5 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.



San Juan, PR
January, 24, 2014

License No. 90
Expiration Date: December 1, 2015

Stamp No. E98712 of Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

As financial management of the Puerto Rico Water Pollution Control Revolving Fund (the "Revolving Fund"), we offer readers of the Revolving Fund's financial statements this narrative overview and analysis of the Revolving Fund's financial performance during fiscal year ended June 30, 2013. This discussion and analysis is designed to assist the reader in focusing on the significant financial matters and activities and to identify any significant changes in the net position of the Revolving Fund. We encourage readers to consider the information presented here in conjunction with the basic financial statements as a whole, which follow this section.

1. FINANCIAL HIGHLIGHTS

- The Revolving Fund's restricted net position increased approximately \$29.1 million or 7.5% over fiscal year 2012 ending balance.
- Contributions received from the U.S. Environmental Protection Agency ("EPA") and the Commonwealth of Puerto Rico (the "Commonwealth") amounted to approximately \$24.6 million, a decrease of approximately \$26 million, or 51.4% from the \$50.6 million received during fiscal year 2012.
- Loan disbursements made by the Revolving Fund to the Puerto Rico Aqueduct and Sewer Authority ("PRASA") to finance its capital improvement program amounted to approximately \$25.3 million, a decrease of approximately \$26 million, or 50.72% from the \$51 million disbursed during fiscal year 2012.
- During the year ended June 30, 2013, the Revolving Fund transferred funds received from the federal government under the American Recovery and Reinvestment Act to PRASA amounting to approximately \$1.2 million.

2. OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Revolving Fund's financial statements, which are comprised of the basic financial statements and the notes to the basic financial statements. Since the Revolving Fund is comprised of a single enterprise fund, no fund level financial statements are shown.

Basic Financial Statements – The basic financial statements are designed to provide readers with a broad overview of the Revolving Fund's finances, in a manner similar to a private-sector business.

The statement of net position presents information on all of the Revolving Fund's assets and liabilities, with the difference between the two reported as net position. Net position increase when revenues exceed expenses. Increases in assets without a corresponding increase to liabilities result in increased net position, which indicate an improved financial position.

The statement of revenues, expenses, and changes in net position presents information showing how an entity's net position changed during the fiscal year. All changes in net position are reported as soon as the underlying event occurs, regardless of timing of related cash flows.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

**MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013**

The last of the required financial statements is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and capital and noncapital financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Notes to the Basic Financial Statements – The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

3. FINANCIAL ANALYSIS

Net position may serve, over time, as a useful indicator of whether a governmental entity's financial position is improving or deteriorating. In the case of the Revolving Fund, assets exceeded liabilities by approximately \$418 million at June 30, 2013. This represents an increase of \$29 million or 7.5% over net position at June 30, 2012. The total amount of net position is restricted as it only serves the purpose provided by the enabling legislation of providing loans and financing for drinking water infrastructure facilities. As of June 30, 2013, most of the loans have been granted to PRASA.

Under Act 75 of July 12, 2010 (the "Act 75"), the Commonwealth guarantees the payment of principal and interest on all of the outstanding Revolving Fund loans issued to PRASA on or before June 30, 2015. As of June 30, 2013, principal in the amount of approximately \$315.3 million, plus any interest accrued on it, out of the \$316 million in outstanding loans are guaranteed by the Commonwealth. The Revolving Fund's management believes that the loans are fully collectible, and has not established an allowance for loan losses.

The operation of the Revolving Fund is subject to the capital financing requirements of PRASA, and/or any other qualifying entity, and therefore, loan origination activity will be determined on an annual basis, depending upon PRASA's and/or any other applying entity's needs.

Condensed financial information on assets, liabilities, and restricted net position is presented below (in thousands):

	<u>June 30,</u>		<u>Change</u>	
	<u>2013</u>	<u>2012</u>	<u>Amount</u>	<u>Percent</u>
Assets:				
Cash	\$ 100,783	\$ 81,952	\$ 18,831	23.0%
Loans	316,464	306,050	10,414	3.4%
Accrued interest receivable	<u>2,966</u>	<u>2,927</u>	<u>39</u>	1.3%
Total assets	420,213	390,929	29,284	7.5%
Liabilities - Accounts payable	<u>1,921</u>	<u>1,778</u>	<u>143</u>	8.0%
Net position - Restricted	<u>\$ 418,292</u>	<u>\$ 389,151</u>	<u>\$ 29,141</u>	7.5%

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

Cash increased to approximately \$101 million at June 30, 2013 from approximately \$82 million at June 30, 2012, for an increase of approximately \$19 million, or 23.0%; and loans increased to approximately \$316.5 million, for a net positive variance of approximately \$10.4 million over 2012 figures. The \$29.1 million growth in net position-restricted was primarily the result of the receipt of approximately \$22.7 million in contributions from EPA during the year. This was the net result of approximately \$18.8 million increase in cash in bank and of approximately \$10.4 million in loans.

Condensed financial information on revenues, expenses, and changes in net position is presented below (in thousands):

	<u>June 30,</u>		<u>Change</u>	
	<u>2013</u>	<u>2012</u>	<u>Amount</u>	<u>Percent</u>
Operating revenues - interest	\$ 6,060	\$ 5,676	\$ 384	6.8%
Operating expenses - general and administrative	<u>(361)</u>	<u>(1,110)</u>	<u>749</u>	-67.5%
Operating income before grants and contributions, and transfers	5,699	4,566	1,133	24.8%
Grants and contributions	24,607	50,604	(25,997)	-51.4%
Contributions to PRASA	<u>(1,165)</u>	<u>(6,216)</u>	<u>5,051</u>	-81.3%
Changes in restricted net position	29,141	48,954	(19,813)	-40.5%
NET POSITION - Beginning of year	<u>389,151</u>	<u>340,197</u>	<u>48,954</u>	14.4%
NET POSITION - End of year	<u>\$ 418,292</u>	<u>\$ 389,151</u>	<u>\$ 29,141</u>	7.5%

Change in net position decreased by approximately \$19.8 million when compared to prior year. Grants decreased approximately \$26 million when compared to grants received during prior year. Note that grants are received to the extent disbursements are required under outstanding loans commitments.

4. REQUESTS FOR INFORMATION

This financial report is designed to provide those interested with a general overview of the Revolving Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Puerto Rico Water Pollution Control Revolving Fund, at Government Development Bank for Puerto Rico, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

**STATEMENT OF NET POSITION
JUNE 30, 2013**

ASSETS:

CURRENT ASSETS:

Cash	\$ 100,782,581
Accrued interest receivable	2,965,585
Loans receivable from Puerto Rico Aqueduct and Sewer Authority	14,614,917
Loans receivable from municipalities	<u>122,989</u>
Total current assets	<u>118,486,072</u>

NONCURRENT ASSETS:

Loans receivable from Puerto Rico Aqueduct and Sewer Authority	300,718,873
Loans receivable from municipalities	<u>1,007,136</u>
Total noncurrent assets	<u>301,726,009</u>
Total assets	<u>420,212,081</u>

LIABILITIES - Accounts payable	<u>1,920,209</u>
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NET POSITION - Restricted	<u><u>\$ 418,291,872</u></u>
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See notes to the basic financial statements.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2013**

OPERATING REVENUE:

Interest income on loans	\$ 5,962,377
Interest income on deposits	97,172
Total interest earned	<u>6,059,549</u>

OPERATING EXPENSES - General and administrative	<u>361,608</u>
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OPERATING INCOME	<u>5,697,941</u>
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NONOPERATING REVENUES / (EXPENSES):

Grants from Environmental Protection Agency	22,727,114
Contributions from Commonwealth of Puerto Rico	1,880,495
Contributions to Puerto Rico Aqueduct and Sewer Authority	<u>(1,165,437)</u>
Total nonoperating revenues	<u>23,442,172</u>

CHANGE IN NET POSITION	29,140,113
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NET POSITION - Beginning of year	<u>389,151,759</u>
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NET POSITION - End of year	<u><u>\$ 418,291,872</u></u>
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See notes to the basic financial statements.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2013

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash paid for general and administrative expenses	<u>\$ (218,912)</u>
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CASH FLOWS FROM INVESTING ACTIVITIES:

Loans disbursements	(25,300,893)
Principal collected on loans	14,886,793
Interest received on loans	5,925,577
Interest received on deposits	95,485
Net cash used in investing activities	<u>(4,393,038)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Funds received from Environmental Protection Agency	22,727,114
Funds received from Commonwealth of Puerto Rico	1,880,495
Contribution to Puerto Rico Aqueduct and Sewer Authority	(1,165,437)
Net cash provided by noncapital financing activities	<u>23,442,172</u>

NET INCREASE IN CASH	18,830,222
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CASH - Beginning of year	<u>81,952,359</u>
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CASH - End of year	<u><u>\$ 100,782,581</u></u>
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RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:

Operating income	\$ 5,697,941
Adjustment to reconcile operating income to net cash used in operating activities:	
Interest income on loans	(5,962,377)
Interest income on deposits	(97,172)
Increase in other liabilities	142,696
Net cash used in operating activities	<u><u>\$ (218,912)</u></u>

See notes to the basic financial statements.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

1. REPORTING ENTITY

Puerto Rico Water Pollution Control Revolving Fund (the “Revolving Fund”) was created by Act 44 of the Legislature of the Commonwealth of Puerto Rico (the “Commonwealth”) on June 21, 1988, as amended. The Revolving Fund was constituted separately and independently from any other funds or resources of the Commonwealth. It is presented as an enterprise fund of the Commonwealth.

The Revolving Fund is administered, pursuant to Act 416 of September 22, 2004, as amended, (the “Act 416”) by the Puerto Rico Environmental Quality Board (“EQB”). Pursuant to the Act 416, EQB, on behalf of the Commonwealth, is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (“EPA”). EQB, Puerto Rico Infrastructure Financing Authority (“PRIFA”), Puerto Rico Aqueduct and Sewer Authority (“PRASA”), and Government Development Bank for Puerto Rico (the “Bank”) entered into a memorandum of understanding under which each party has agreed to assume specific responsibilities in connection with the operations of the Revolving Fund. Under the memorandum of understanding, the Bank provides assistance in maintaining the accounting records of the Revolving Fund.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Revolving Fund conform to Accounting Principles Generally Accepted in the United States of America (“GAAP”), for governments as prescribed by the Governmental Accounting Standards Board (“GASB”).

Effective July 1, 2012, the Revolving Fund adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This statement provides financial reporting guidance for deferred outflows of resources, which are consumptions of net position by the government that is applicable to a future reporting period and deferred inflows of resources which are acquisitions of net position by the government that is applicable to a future reporting period. Statement No. 63 amends the net asset reporting requirements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The adoption of Statement No. 63 resulted in a change in the presentation of the Statement of Net Assets to what is now referred to as the Statement of Net Position and the term “net assets” is changed to “net position” throughout the basic financial statements. The Revolving Fund had no deferred outflows or deferred inflows of resources as permitted by Statement No. 63, at June 30, 2013.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of changes in net position and revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Following is a description of the Revolving Fund’s most significant accounting policies:

Measurement Focus, Basis of Accounting, and Financial Statements Presentation — The Revolving Fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

The statement of net position and the statement of revenues, expenses, and changes in net position report information on all activities of the Revolving Fund. The Revolving Fund's activities are distinguished as proprietary activities. Revolving Fund's activities generally are financed through intergovernmental revenues and other non-exchange revenues. Following is a description of the Revolving Fund's financial statements.

The statement of net position presents the Revolving Fund's assets and liabilities, with the difference reported as net position. Net positions may be reported as:

- Restricted component of net position consists of restricted assets reduced by liabilities related to those assets. Restricted net position result when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted component of net position consists of net amount of the assets and liabilities that do not meet the definition of the two preceding categories. Unrestricted component of net position often is designated in order to indicate that management does not consider them to be available for general operations. Unrestricted component of net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of revenues, expenses, and changes in net position demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include interest income on loans and deposits. Operating expenses are those that relate to the administration of the Revolving Fund. Other items not meeting the definition of program revenues or operating expense are reported as non-operating revenues or expenses.

Loans Receivable and Allowance for Loan Losses — Loans are presented at the outstanding unpaid principal balance. As explained further below, management believes the inherent credit risk of its loan portfolio is mitigated by the fact that there have been no historical losses in such portfolio. Accordingly, no allowance for loan losses has been established for them. The accrual of interest ceases only when management determines that all of the following characteristics are present, thus the mere existence of several but not all of these attributes does not warrant the discontinuance of interest income recognition: (a) a loan is six months past due; (b) it has no definitive source of repayment; (c) it is not covered by a formal commitment from the Commonwealth; and (d) it has no designated collateral or such collateral is insufficient. If a loan is placed in nonaccrual status, all accrued interest receivable is reversed from interest income. Interest income on nonaccrual loans is, thereafter, recognized as income only to the extent actually collected. Nonaccrual loans are returned to an accrual status when management has adequate evidence to believe that the loans will be performing as contracted. The Revolving Fund does not have loans on nonaccrual status as of June 30, 2013.

When required, the allowance for loan losses will be established through provisions recorded in the financial statements. This allowance is based on management's evaluation of the risk characteristics of the loan including such factors as the nature of individual credits outstanding, past loss experience, known and inherent risks in the portfolios, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and general economic conditions. If necessary, loan charge-offs will be recorded against the allowance when management believes that the collection of the principal is unlikely. Recoveries of amounts previously charged off are credited to the respective allowance. Because of uncertainties inherent in the estimation process, management estimate of credit

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

losses in the outstanding loans receivable portfolios and the related allowance may change in the near future.

Management, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Revolving Fund will be unable to collect all amounts due according to the contractual terms of the loan agreement. Interest income and cash receipts on impaired loans are accounted for predominantly in the same manner as nonaccrual loans.

If a loan is considered to be impaired it will be generally reduced to the present value of expected future cash flows, discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent, by establishing a valuation allowance. The Revolving Fund does not have impaired loans as of June 30, 2013.

Management believes that no losses will be incurred by the Revolving Fund with respect to principal and interest on most of its loans to PRASA and to municipalities, as a result, no allowance for loan losses is generally established for them. As of June 30, 2013, the Revolving Fund has approximately \$125.7 million in undisbursed commitments of loans to extend additional credit to PRASA.

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2013:

- (a) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or vice versa. In the case of the Revolving Fund, as there are no deferred outflows or deferred inflow of resources, no impact is expected from the future adoption of this statement. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.
- (b) GASB Statement No. 66, *Technical Corrections – 2012 - an amendment of GASB Statements No. 10 and No. 62*. The objective of this Statement, among other provisions, is to amend Statement No. 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. No impact is expected upon the adoption of this statement on July 1, 2013.
- (c) GASB Statement No. 67, *Financial Reporting for Pension Plans — an amendment of GASB Statement No. 25*. The objective of this Statement is to improve financial reporting by state

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

and local governmental pension plans. The major fundamental change, among others related to the application and determination of certain measurement assumptions in valuing pension plans, is switching from the existing “funding-based” accounting model, where currently the Annual Required Contribution (ARC) is compared to the actual payments made and that difference determines the Net Pension Obligation; to an “accrual basis” model similar to current Financial Accounting Standards Board (FASB) standards, where the Total Pension Obligation (Actuarially determined) is compared to the Net Plan Position and the difference represents the Net Pension Liability. This particular Statement will not be applicable to the Revolving Fund, as the Revolving Fund does not have its own pension plan; on the other hand, this will be applicable to the three Employees’ Retirement Systems of the Commonwealth (the Retirement Systems). However, this change applicable to only the Retirement Systems, will have an impact on the different government agencies and public corporations, including the Revolving Fund, when GASB Statement No. 68, discussed below, is adopted effective for fiscal year 2015. The provisions of this Statement are effective for the financial statements of the Retirement Systems for periods beginning after June 15, 2013.

- (d) GASB Statement No. 68, *Accounting and Financial Reporting for Pensions — an amendment of GASB Statement No. 27*. This Statement, among other requirements, will bring the effect of Statement 67 summarized above, into the accounting records of the individual agencies, public corporations and municipalities, whose employees participate in the Retirement Systems. The Revolving Fund, as well as the other component units of the Commonwealth and the municipalities, are considered “cost-sharing” employers of the Retirement Systems; therefore, a government participating in the Retirement Systems, such as the Revolving Fund, would report the resulting Net Pension Liability from Statement 67 as follows:
- ✓ Based on the Revolving Fund’s proportion of the collective net pension liability of all the governments participating.
 - ✓ The proportion should be consistent with the method used to assess contributions (percentage of payroll).

The impact of the effects of this Statement on the Revolving Fund’s basic financial statements is not expected to be significant as the Revolving Fund currently has no employees participating in Retirement Systems. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.

- (e) GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfer of operations. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.
- (f) GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. This Statement requires a governmental entity guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

**NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013**

on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. Certain qualitative factors should be considered when evaluating the likelihood of a guaranty payment, such as: initiation of a bankruptcy process, breach of a debt contract in relation to the guaranteed obligation and indications of significant financial difficulty to pay agents or trustees. This Statement is not expected to have any impact on the Revolving Fund as the Revolving Fund has no financial guarantees outstanding at June 30, 2013. This Statement is effective for financial statements for periods beginning after June 15, 2013.

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the Revolving Fund's deposit may not be returned to it. The Revolving Fund does not have a policy for custodial credit risk. As of June 30, 2013, all of the Revolving Fund's bank balance, aggregating approximately \$101,000,000, was exposed to custodial credit risk since such deposits, all of which are maintained at the Bank, are uninsured and uncollateralized.

4. LOANS RECEIVABLE

Loans receivable at June 30, 2013, consist of:

Description	Amount
Permanent loans:	
PRASA	\$ 189,235,936
Municipalities	<u>1,130,124</u>
Total permanent loans	190,366,060
Construction loans — PRASA	<u>126,097,855</u>
Total loans receivable	<u><u>\$ 316,463,915</u></u>
 Reconciliation to the statement of net position	
Current portion:	
PRASA	\$ 14,614,917
Municipalities	<u>122,989</u>
Total current portion	<u>14,737,906</u>
Noncurrent portion:	
PRASA	300,718,873
Municipalities	<u>1,007,136</u>
Total noncurrent portion	<u>301,726,009</u>
Total loans receivable	<u><u>\$ 316,463,915</u></u>

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NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

Permanent loans are due in semiannual installments bearing interest at 2% per annum maturing on various dates through December 31, 2031. Permanent loans receivable at June 30, 2013 mature as follows:

<u>Years Ending on June 30,</u>	<u>Amount</u>
2014	\$ 14,737,906
2015	14,975,592
2016	14,435,265
2017	14,232,302
2018	13,354,649
Thereafter	<u>118,630,346</u>
	<u>\$ 190,366,060</u>

Construction loans bear interest at 2% per annum and principal will be payable semiannually commencing no later than one year after construction completion date. The loans are required to be paid in full in a period not to exceed 20 years after the construction loan is converted to a permanent loan. Interest on construction loans are payable semiannually since inception of loan.

The Revolving Fund is operated as a direct loan program, whereby most of the loans made are funded by capitalization grants from the EPA and a Commonwealth match equaling 20% of the EPA capitalization grant. Some of the outstanding loans were 100% funded with EPA capitalization grants. Under Act 75 of July 12, 2010 (the "Act 75"), the Commonwealth guarantees the payment of principal and interest on all the outstanding Revolving Fund loans issued to PRASA on or before June 30, 2015.

5. TRANSACTIONS WITH GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO

Since the Revolving Fund has no employees, the Bank provided certain management services to the Revolving Fund at no cost during the year ended June 30, 2013.

6. CAPITALIZATION GRANTS

The Clean Water Act (the "CWA"), as amended, is the main federal law that establishes the basic structure for regulating discharges of pollutants into waters of the United States and for regulating quality standards for surface waters. Under CWA, EPA has implemented pollution control programs such as setting wastewater standards for industry and quality standards for all contaminants in surface waters. The CWA created the federal Clean Water State Revolving Fund to make funds available to finance water quality protection projects for wastewater treatment, nonpoint source pollution control, and watershed and estuary management that are needed to comply with the CWA water pollution requirements. The CWA authorizes the EPA to award capitalization grants to state which, in turn, provide low interest loans and other types of financial assistance to eligible systems. These grants are routinely subject to financial and compliance audits in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133 and compliance audits by EPA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance. All funds drawn from EPA and the matching funds from the Commonwealth are recorded as non-operating revenues. As

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**NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2013**

of June 30, 2013, EPA has awarded capitalization grants of \$440,692,899 to the Revolving Fund of which \$344,662,504 has been drawn for loans and administrative expenses.

The following summarizes the capitalization grant awarded, amounts drawn on each grant as of the statement of position date, and balances available for future draws:

<u>June 30,</u>	<u>Grant Amount</u>	<u>Total Draws at June 30, 2012</u>	<u>Draws During 2013</u>	<u>Total Draws at June 30, 2013</u>	<u>Available at June 30, 2013</u>
1989	\$ 12,302,136	\$ 12,302,136	\$ -	\$ 12,302,136	\$ -
1990	12,724,965	12,724,965	-	12,724,965	-
1991	26,767,224	26,767,224	-	26,767,224	-
1992	25,341,921	25,341,921	-	25,341,921	-
1993	25,068,780	24,930,085	-	24,930,085	138,695
1994	15,554,979	15,554,979	-	15,554,979	-
1995	16,064,829	13,652,421	2,551,106	16,203,527	(138,698)
1996	26,314,675	25,454,673	860,002	26,314,675	-
1997	8,110,800	6,670,502	853,828	7,524,330	586,470
1998	17,562,897	19,244,428	-	19,244,428	(1,681,531)
1999	17,564,382	16,281,656	-	16,281,656	1,282,726
2000	17,504,784	14,328,469	2,810,367	17,138,836	365,948
2001	31,349,156	14,000,000	10,407,426	24,407,426	6,941,730
2002	17,387,865	16,808,269	-	16,808,269	579,596
2003	18,322,900	9,089,162	-	9,089,162	9,233,738
2004	17,285,301	16,709,124	-	16,709,124	576,177
2005	14,054,535	95,226	-	95,226	13,959,309
2006	11,421,333	3,902,759	552,915	4,455,674	6,965,659
2007	13,959,396	439,217	-	439,217	13,520,179
ARRA	51,114,200	47,638,174	2,778,254	50,416,428	697,772
2008	9,475,941	-	1,570,544	1,570,544	7,905,397
2009	8,864,900	-	-	-	8,864,900
2010	26,575,000	-	342,672	342,672	26,232,328
	<u>\$ 440,692,899</u>	<u>\$ 321,935,390</u>	<u>\$ 22,727,114</u>	<u>\$ 344,662,504</u>	<u>\$ 96,030,395</u>

At June 30, 2013, the Revolving Fund have \$18,434,000 and \$19,259,000 from grants awarded by EPA during the federal fiscal years ended September 30, 2012 and 2011, respectively, that are available to be drawn for loan commitments and/or administrative expenses once all the EPA requirements have been met. As of June 30, 2013, no amounts were available to be drawn for the year ended June 30, 2013. See Note 8 for subsequent events.

7. ADMINISTRATIVE EXPENSES

As provided by federal laws and regulations, reasonable costs of administering the Revolving Fund are reimbursable under federal programs up to a maximum of 4% of the capitalization grant awarded each year. The federal government also reimburses expenses incurred in training and certifying personnel as well as technical matters. During 2013, there was no reimbursement of administrative expenses.

PUERTO RICO WATER POLLUTION CONTROL REVOLVING FUND

NOTES TO BASIC FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED JUNE 30, 2013

8. SUBSEQUENT EVENTS

In October 2013, the EPA awarded to the Revolving Fund \$17,413,000, for the federal fiscal year ended September 30, 2013, to be drawn for loan commitments or administrative expenses once all the EPA requirements have been met.

Subsequent events were evaluated through January 24, 2104, the date the financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the 2013 financial statements.