

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

AUDITED FINANCIAL STATEMENTS AND
FOR THE YEAR ENDED JUNE 30, 2012
TOGETHER WITH INDEPENDENT AUDITORS' REPORT

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

TABLE OF CONTENTS

	Page(s)
Independent Auditors' Report	1-2
Managements' Discussion and Analysis	3-11
Financial Statements	
Statement of Net Assets	12
Statement of Revenues, Expenses and Changes in Net Assets	13
Statement of Cash Flows	14-15
Notes to Financial Statements	16-28

INDEPENDENT AUDITORS' REPORT

Hon. Rubén A. Hernández Gregorat, MLM, P.F.
Secretary Department of Transportation and Public Works

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

Except as discussed in the following paragraph, 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 of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

The Authority did not provide an actuarial valuation report to record the liability and current year cost of the certain post-employment benefits described in Note 13 to the financial statements as required by accounting principles generally accepted in the United States of America ("GAAP"). The cost of these benefits are recorded in the financial statements when paid which is a method not accepted by GAAP.

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

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

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 12 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.

Guzmán, Torres Castro & Díaz, CPAs PSC
Certified Public Accountants
November 5, 2012

Stamp # 2667366
was affixed to the original of this report.

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

The following discussion and analysis of the financial performance and activity of the Puerto Rico Metropolitan Bus Authority ("the Authority") provides an introduction and understanding of the basic financial statements of the Authority for the fiscal years ended June 30, 2012 and 2011. This discussion was prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Financial Highlights for 2012

- Net assets deficiency totaled \$25.3 million at June 30, 2012.
- Net assets deficiency increased by \$11 million in 2012, as compared to a decrease of approximately \$1.3 million in 2011.
- Net capital assets totaled \$52.3 million at June 30, 2012.
- Net capital assets decreased by 18.2% at June 30, 2012, when compared with the balance at June 30, 2011 of \$63.9 million.

Financial Highlights for 2011

- Net assets deficiency totaled \$14.4 million at June 30, 2011.
- Net assets deficiency decreased by \$1.3 million in 2011, as compared to a decrease of approximately \$3.4 million in 2010.
- Net capital assets totaled \$63.9 million at June 30, 2011.
- Net capital assets increased by 3.5% at June 30, 2011, when compared with the balance at June 30, 2010 of \$61.8 million.

The Financial Statements

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

Overview of the Financial Statements for Business-Type Activities

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

Statement of Net Assets

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

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

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

Statement of Revenues, Expenses, and Changes in Net Assets

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

Statement of Cash Flows

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

Notes to Financial Statements

The notes to financial statements are an integral part of the basic financial statements and describe the significant accounting policies, related-party transactions, deposits and investments, capital assets, long-term liabilities, defined-benefit pension plans, and the commitments and

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

contingencies. The reader is encouraged to review the notes in conjunction with the management discussion and analysis and the financial statements.

Financial Analysis of the Authority's Business-Type Activities

Statements of Net Assets

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

	June 30,		
	2012	2011	2010
ASSETS			
Current assets	\$ 17,286,855	\$ 18,108,854	\$ 31,217,692
Capital assets	52,263,013	63,888,985	61,736,522
Other assets	542,071	542,071	542,071
Total assets	<u>\$ 70,091,939</u>	<u>\$ 82,539,910</u>	<u>\$ 93,496,285</u>
LIABILITIES			
Current liabilities	\$ 48,651,648	\$ 54,664,849	\$ 69,109,362
Long-term liabilities	46,776,737	42,208,715	39,960,553
Total liabilities	<u>95,428,385</u>	<u>96,873,564</u>	<u>109,069,915</u>
NET ASSETS			
Invested in capital assets, net of related debt	52,263,013	61,378,044	44,597,923
Deficiency in unrestricted net assets	<u>(77,599,459)</u>	<u>(75,711,698)</u>	<u>(60,171,553)</u>
Total net assets deficiency	<u>(25,336,446)</u>	<u>(14,333,654)</u>	<u>(15,573,630)</u>
Total liabilities and net assets	<u>\$ 70,091,939</u>	<u>\$ 82,539,910</u>	<u>\$ 93,496,285</u>

June 30, 2012

Current assets decreased by 4.5% to \$17.3 million. All categories of current assets remained comparable to prior year.

Capital assets decreased by 18.2% to \$52.2. This decrease is the net result of the depreciation for the year amounting to \$9 million net of capital assets additions of \$1.2 million. In addition during the year the Authority charged to expense about \$5 million previously recorded as construction in progress for cost incurred in the overhaul of certain transportation equipment

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

because new evidence obtained during the year indicated that such overhaul does not increase the useful life of the related asset. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the U.S. Federal Transit Administration which is used to finance the acquisition and maintenance of capital assets.

During the year ended June 30, 2012 the Authority completed an evaluation of its capital assets as part of the implementation of a capital ledger system. To perform this analysis the Authority obtained all capital assets acquisitions and records from year 2000 to present fiscal year and based on that information and analysis determined that the net book value of capital assets as of July 1, 2009 was overstated by approximately \$2.6 million. Therefore prior years financial statements were restated to reflect the effect of this adjustments.

Current liabilities decreased by 11% to \$48.7 million. This increase consists principally of a decrease in amounts outstanding under a line of credit which was refinanced on a long-term basis as explained above and a decrease in accounts and accrued expenses payable of \$4 million.

Effective March 2012 the Authority refinanced amounts outstanding with a private bank under a line of credit in the amount of \$3 million and a long-term loan in the amount of \$34.5 million into a long-term loan with the same bank. The new loan matures on March 2015 and is payable in monthly principal installments of \$209,000 plus interest. Interest on outstanding balance is based on a margin over LIBOR based on the debt rating given to the Commonwealth of Puerto Rico's general obligations by Moody's Corporation and Standard & Poors Financial Services LLC as defined in the agreement (2.62% at June 30, 2012). The note is secured by the assignment of the diesel tax revenues allocated by the Commonwealth of Puerto Rico.

Net assets deficiency increased by 77% to a net deficiency of \$25.3 million. This increase was the result of an excess of expenses (operating and non-operating) over revenues (operating and non-operating) and capital grants of \$11 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

June 30, 2011

Current assets decreased by 42% to \$18.1 million. The change in current assets is primarily due to a decrease in account receivable from Federal Transit Administration of \$18 million.

Capital assets increased by 3.5% to \$63.9 million principally for the acquisition of transportation equipment net of related depreciation for the year. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

Transportation Capital and Operating Assistance Formula Grant" granted by the U.S. Federal Transit Administration which is used to finance the acquisition and maintenance of capital assets. Total capital grants received during fiscal year 2011 from the Commonwealth of Puerto Rico and the Transit Administration amounted to approximately \$12.2 million.

Current liabilities decreased by 20.9% to \$54.7 million. The decrease is related to decrease in the accounts payable related to acquisition of capital assets which were paid with capital grants for from U.S. Federal Transit Administration.

Long-Term Debt consists principally of amounts due to Scotia Bank of Puerto Rico related to a long-term financing obtained in prior years. The loan with Scotia Bank is payable in monthly principal installment of \$143,334 plus interests at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2011) due in February 12, 2012. As explained above, effective March 2012, the amount outstanding on this loan together with the amount outstanding under a line of credit was refinanced on a long-term basis.

Net assets deficiency decreased 8% to a net deficiency of \$14.3 million. This decrease was the result of an excess of revenues (operating and non-operating) over expenses (operating and non-operating) and capital grants of \$1.3 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

	Years Ended June 30,		
	2012	2011	2010
Operating revenues	\$ 5,395,378	\$ 9,248,546	\$ 6,313,102
Operating expenses	100,517,106	88,747,879	85,153,876
Operating loss	<u>(95,121,728)</u>	<u>(79,499,333)</u>	<u>(78,840,774)</u>
Non-operating revenues:			
Operating grants	86,134,166	73,723,710	66,952,499
Interest income (expense), net	(4,193,476)	(5,166,258)	(4,131,901)
Total non-operating revenues	<u>81,940,690</u>	<u>68,557,452</u>	<u>62,820,598</u>
Loss before capital contributions	(13,181,038)	(10,941,881)	(16,020,176)
Capital contributions	2,178,246	12,181,857	22,833,564
Change in net assets	(11,002,792)	1,239,976	6,813,388
Net assets deficit at beginning of year	<u>(14,333,654)</u>	<u>(15,573,630)</u>	<u>(22,387,018)</u>
Net assets deficit at end of year	<u>\$ (25,336,446)</u>	<u>\$ (14,333,654)</u>	<u>\$ (15,573,630)</u>

Year Ended June 30, 2012

Operating revenues which consisted principally of fares for transportation and other services, decreased by 42% to \$5.4 million. During the year ended June 30, 2012 the Authority recognized revenue from a contract with the Puerto Rico Highways and Transportation Authority (PRPHA) in the amount of \$1.1 million. This revenue consists of the amount billed for services performed during the year ended June 30, 2012. Operating revenues decreased because of 2011 the Authority recognized revenue under the contract with PRPHA related to fiscal years 2010 and before in the amount of approximately \$3 million as explained below.

Operating expenses, which consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased by 13.2% to \$100.5 million. This increase is due to the following:

During the year ended June 30, 2012 the Authority, following guidelines from U.S. Federal Transit Authority, performed a mid-life overhaul to certain of its transportation equipment. This overhaul is performed when the units reach its mid-life, generally 6 years, in order for the unit to last its estimated useful life of 12 years. Since the overhaul does not result in an increase in the useful life of the unit it is recorded as an operating expense. Total cost of this overhaul is

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

amounted to approximately \$11 million and recorded as repairs and maintenance in the accompanying financial statements.

During the year ended the Authority continued with the implementation of the voluntary retirement plan that commenced during fiscal year 2011.

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the Authority. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited service in the Retirement System and will consist of biweekly benefits ranging from 37.5% to 50 % of each employee' salary, as defined. In this early retirement benefit program, the Authority will make the employer contributions to the Retirement System and pay the corresponding pension until the employee complies with the requirements of age and 30 years of credited service in the Retirement System. Economic incentives are available to eligible employees who have less than 15 years of credited service in the Retirement System or who have at least 30 years of credited service in the Retirement System and the age for retirement or who have the age for retirement. Economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary based on employment years. Additionally, eligible employees that choose to participate in the early retirement benefit program or that choose the economic incentive and have less than 15 years of credited service in the Retirement System are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Commonwealth of Puerto Rico.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately 8.1 million in the statement of net assets as of June 30, 2012 and a charge of \$5 million in the statement of activities for the year ended June 30, 2012. At June 30, 2012, unpaid long-term benefits granted on this program were discounted at 1.46%. The impact of \$5 million is recorded as salaries and related benefits in the accompanying financial statements.

Non-operating revenues consisted principally of operating grants from the Commonwealth of Puerto Rico and Federal Government. These operating grants from the Commonwealth of Puerto Rico are annual appropriations from the general fund. The amount appropriated annually depends on the approved budget of the Commonwealth of Puerto Rico.

In addition, the Authority receives operating and capital contributions from the U.S. Federal Transit Administration which are restricted to the acquisition and repairs of certain capital assets.

During the year ended June 30, 2012 non-operating revenues increased by 13.7% due to an increase in grants received from U.S. Federal Transportation Authority used to finance part of

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

mid-life overhaul described above and an increase in operating grants received from the Commonwealth of Puerto Rico used to finance the Authority's operating deficit.

Year Ended June 30, 2011

Operating revenues which consisted principally of fares for transportation and other services, increased by 46.5% to \$9.3 million. During the year ended June 30, 2011 the Authority recognized revenue from a contract with the Puerto Rico Highways and Transportation Authority in the amount of \$4,451,768. This revenue consist of the amount billed for services performed during the year ended June 30, 2011 plus prior years unrecorded amounts because such revenue was considered uncollectible in prior years in accordance with a resolution approved by the Secretary of the Department of Transportation and Public Works which authorizes the payment of all the amounts billed.

Operating expenses, which consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased by 4.2% to \$88.8 million. This increase is due cost of a voluntary retirement termination plan implemented during this year as explained above.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately \$4 million in the statement of net assets as of June 30, 2011 and a charge of \$4.9 million in the statement of activities for the year ended June 30, 2011. At June 30, 2011, unpaid long-term benefits granted on this program were discounted at 2.99%. The impact of \$4.9 million is recorded as salaries and related benefits in the accompanying financial statements.

Non-operating revenues consisted principally of operating grants from the Commonwealth of Puerto Rico and Federal Government. These operating grants from the Commonwealth of Puerto Rico are annual appropriations from the general fund. The amount appropriated annually depends on the approved budget of the Commonwealth of Puerto Rico.

In addition, the Authority receives operating and capital contributions from the U.S. Federal Transit Administration which are restricted to the acquisition and repairs of certain capital assets.

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2012 AND 2011

(Unaudited)

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2012, the Authority had invested approximately \$52.2 million in capital assets (net of related depreciation) including transportation equipment, land, buildings and structures and machinery and equipment used in the operations. At June 30, 2011, the Authority had invested approximately \$63.9 million in capital assets.

Major capital assets events during the years ended June 30, 2012 and 2011 include the acquisition and repairs of transportation equipment which were funded principally by capital contributions received.

Debt Administration

Effective March 2012 the Authority refinanced amounts outstanding with a private bank under a line of credit in the amount of \$3 million and a long-term loan in the amount of \$34.5 million into a long-term loan with the same bank. The new loan matures on March 2015 and is payable in monthly principal installments of \$209,000 plus interest. Interest on outstanding balance is based on a margin over LIBOR based on the debt rating given to the Commonwealth of Puerto Rico's general obligations by Moody's Corporation and Standard & Poors Financial Services I.T.C as defined in the agreement (2.62% at June 30, 2012). The note is secured by the assignment of the diesel tax revenues allocated by the Commonwealth of Puerto Rico.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our customers, investors, creditors, and the general public with a general overview of the Puerto Rico Metropolitan Bus Authority's finances and to how it utilizes the economic resources that it receives. If you have questions about this report or need additional financial information, contact the administration Office at Puerto Rico Metropolitan Bus Authority, 37 De Diego Avenue, San Juan, Puerto Rico.

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET ASSETS

JUNE 30, 2012

Assets:

Current Assets:

Cash and cash equivalents	\$ 4,103,874
Accounts receivable	7,982,562
Inventory	3,148,861
Prepaid expenses	2,051,558
Total current assets	<u>17,286,855</u>

Capital assets, net of accumulated depreciation 52,263,013

Other assets 542,071

Total assets \$ 70,091,939

Liabilities:

Current liabilities:

Accounts and accrued expenses payable	\$ 43,701,832
Deferred revenue	2,238,354
Current portion of long-term debt	2,711,462
Total current liabilities	<u>48,651,648</u>

Non-Current Liabilities

Notes payable, net of current portion	34,336,590
Other non-current liabilities	12,440,147
Total non-current liabilities	<u>46,776,737</u>

Net assets (deficit)

Invested in capital assets, net of related debt	52,263,013
Unrestricted deficit	<u>(77,599,459)</u>
Net assets (deficit)	<u>(25,336,446)</u>

Total liabilities and net assets (deficit) \$ 70,091,939

The accompanying notes are integral part of the financial statements.

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2012

Operating revenues:	
Passenger fares	\$ 5,022,797
Advertising and other	372,581
Total operating revenues	<u>5,395,378</u>
Operating expenses:	
Salaries and employee benefits, including voluntary termination benefits of \$4,939,000	63,390,100
Diesel, gasoline, oil and lubricants	6,917,722
Depreciation and amortization	9,097,168
Materials, spare parts and repairs and maintenance	15,794,723
Utilities	1,362,534
Professional services	2,545,721
General and administrative	1,409,138
Total operating expenses	<u>100,517,106</u>
Operating loss	<u>(95,121,728)</u>
Non-operating revenues (expenses)	
Gasoline, diesel, petroleum and tax oil revenues	10,118,207
Operating grants:	
Commonwealth of Puerto Rico operating grant	61,623,228
Federal Transit Administration	14,392,731
Interest and other financing expenses	(4,196,228)
Interest income	2,752
Total non-operating revenues	<u>81,940,690</u>
Loss before capital contributions	<u>(13,181,038)</u>
Capital contributions	<u>2,178,246</u>
Change in net assets	<u>(11,002,792)</u>
Net assets deficiency	
Beginning of year:	
As previously reported	(11,514,366)
Restatement of prior years financial statements	(2,819,288)
As restated	<u>(14,333,654)</u>
End of year	<u>\$ (25,336,446)</u>

The accompanying notes are integral part of the financial statements

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

Cash flows from operating activities:	
Cash received from customers and users	\$ 4,290,286
Cash payments to suppliers for goods and services	(33,065,359)
Cash payments to employees for services	(51,398,284)
Net cash used in operating activities	<u>(80,173,357)</u>
Cash flows from non-capital financing activities:	
Operating grants received from:	
U.S. Federal Transit Administration	16,534,342
Commonwealth of Puerto Rico	70,939,585
Interest paid	(2,900,714)
Payment of notes payable	(1,785,248)
Net cash provided by non-capital financing activities	<u>82,787,965</u>
Cash flows from capital and related financing activities:	
Acquisition of capital assets	(4,982,424)
Capital contributions	2,178,246
Net cash used in capital and related financing activities	<u>(2,804,178)</u>
Cash flows from investing activities:	
Interest received	<u>2,752</u>
Net decrease in cash and cash equivalents	(186,818)
Cash and cash equivalents:	
Beginning of year	4,290,692
End of year	<u>\$ 4,103,874</u>

The accompanying notes are integral part of the financial statements

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

Reconciliation of operating loss to net cash

used in operating activities:

Operating loss	\$ (95,121,728)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	9,097,168
Decrease in capital assets	5,000,287
Changes in operating assets and liabilities:	
Accounts receivable	(1,105,092)
Inventory	171,495
Prepaid expenses	229,017
Accounts and accrued expenses payable	(1,635,229)
Voluntary termination benefits long-term	3,190,725
Net cash used in operating activities	<u>\$ (80,173,357)</u>

Schedule of Non-Cash Transactions:

Refinancing of line of credit and term loan	<u>\$ 37,543,294</u>
---	----------------------

The accompanying notes are integral part of the financial statements

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

1. Organization and Summary of Significant Accounting Policies

The Puerto Rico Metropolitan Bus Authority (the "Authority") is a public corporation created by Act No. 5 of May 11 1959, as amended, to provide, develop, manage and maintain a public low-cost land transportation system for citizens within the Metropolitan Area of San Juan, Bayamon, Carolina, Guaynabo, Cataño, Loiza, Toa Baja and Trujillo Alto of Puerto Rico. This service is principally financed by appropriations from the Commonwealth of Puerto Rico, grants from the Federal Government and by passenger fares. The Authority is a component unit of the Commonwealth of Puerto Rico, and accordingly is included in the general-purpose financial statements of the Commonwealth. The powers normally exercised by a Board of Directors are vested with the Secretary of the Department of Transportation and Public Works (DTPW). The Authority is exempt from the payment of any taxes on its revenues and properties.

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

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

Following is a description of the Authority's most significant accounting policies:

Measurement Focus and Basis of Accounting

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

Use of Estimates

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

Cash and Cash Equivalents

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

Allowance for Doubtful Accounts

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

Inventories

Inventories, consisting of fuel, spare parts, materials and supplies are valued at the lower of cost (weighted average method) or market.

Capital Assets

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

The estimated useful lives of the capital assets follow:

Buildings and structures	40 years
Transportation equipment	5-12 years
Terminals	20 years
Machinery and equipment	5-10 years

The Authority periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No impairment of capital asset was identified during the year ended June 30, 2012.

Vacation and Sick Leave

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

Net assets

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

Invested in Capital Assets, Net of Related Debt

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

Unrestricted

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

Operating Revenues and Expenses

The Authority distinguishes between operating and nonoperating revenues and expenses in its Statement of Revenues, Expenses, and Changes in Net Assets. The principal revenues of the Authority are charges received from patrons for the transportation services provided. The Authority also recognizes as operating revenue advertising charges to customers and other related transportation services. Operating expenses for the Authority include the costs of operating the transportation facilities, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Contributions

The Authority is a recipient of Federal funds received under grants with U.S. Federal Transit Administration (FTA) for the exclusive purpose of acquisition and repairs of certain capital assets with certain matching funds provided by the Commonwealth of Puerto Rico. Capital grants of the Authority are reported as non-operating revenues rather than contributed capital as required by GASB Statement No 33, *Accounting and Financial Reporting for Non-exchange Transactions*. Capital funding provided under these grants is considered earned as the related allowable expenditure is incurred.

In addition, the Authority receives operating and capital grants from the Commonwealth of Puerto Rico. This grant, which is subject to annual appropriations, is used to finance the Authority's operations and acquisition of capital assets. Amounts received under this grant are recorded as revenues in the period stated in the grant.

Risk Financing

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

Accrual for legal claims

The estimated amount of the liability for legal claims is recorded on the accompanying Statements of Net Assets based on the Authority's evaluation of the probability of an unfavorable outcome in the litigation of such legal claims. The Authority consults with legal counsel upon determining whether an unfavorable outcome is expected. Because of uncertainties inherent in the estimation process, management's estimate of the liability for legal claims may change in the near term.

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

Recently Adopted GASB Statements

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

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

Recently Statements Issued by GASB

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

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

The GASB has also issued Statement No. 61, The Financial Reporting Entity: Omnibus - An Amendment of GASB Statements Nos. 14 and 34 which is effective for fiscal years

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

beginning after December 31, 2011. The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. The Authority has not yet determined the effect, if any, that the adoption of GASB 61 may have on its financial statements.

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

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

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

2. Cash and Cash Equivalents

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

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

Pursuant to the Investment Guidelines for the Commonwealth adopted by Government Development Bank for Puerto Rico ("GDB"), the Authority may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, repurchase agreements, bankers acceptances, or in pools of obligations of the municipalities of Puerto Rico, among others. There are no investments at June 30, 2012.

For deposits, custodial credit risk is the risk that in the event of bank failure, the Authority's deposits may not be returned to it. Under Puerto Rico statutes public funds deposited in commercial bank must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth of Puerto Rico. The bank balance of the Authority's deposit at June 30, 2012, excluding deposits in Government Development Bank for Puerto Rico described below, amounted to approximately \$3,183,404 of which \$1,325,727 is insured by Federal Deposit Insurance Corporation at June 30, 2012.

In addition, at June 30, 2012, the Authority maintained cash deposited at the Governmental Development Bank for Puerto Rico (GDB), in the amount approximately \$108,520. These amounts are uncollateralized since by law, the governmental banks of the Commonwealth of Puerto Rico are exempt of the requirement of insuring the deposits of funds of the entities of the Commonwealth of Puerto Rico.

3. Accounts Receivable

Accounts receivable at June 30, 2012 consist of:

Operating and capital grants:	
U.S. Federal Transit Administration	\$ 586,698
Commonwealth of Puerto Rico	2,106,513
Puerto Rico Highways and Transportation Authority	5,617,660
Other	718,390
Total	<u>9,029,261</u>
Less allowance for doubtful accounts	1,046,699
Total	<u>\$ 7,982,562</u>

Account receivable from U.S Federal Transit Administration ("FTA") consists principally of operating and capital contributions pending to be received at June 30, 2012.

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED JUNE 30, 2012

The account receivable from the Puerto Rico Highways and Transportation Authority (PRTHA) consists of amounts due under a contract with PRTHA in which the Authority provides transportation services to passengers using the urban train system. Under the term of the contract PRTHA will reimburse the Authority certain amounts specified in the contract for each passenger served. The amount outstanding represents the amount billed to PRTHA for services performed since July 2005 to June 30, 2012. At June 30, 2012 management is in the process of discussing the amounts billed with PRTHA in order to settle the amount outstanding. Management believes that the amount outstanding represents billings for services performed under the term of the contract and that the amount will be collected.

4. Inventory

Inventory at June 30, 2012 consists of:

Spare parts	\$ 178,606
Diesel and gasoline	2,832,811
Supplies	137,444
Total	<u>\$ 3,148,861</u>

5. Accounts and Accrued Expenses Payable

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

Suppliers	\$ 2,924,402
Agencies and public corporations of the Commonwealth of Puerto Rico	26,842,364
Compensated absences and other related benefits	7,958,691
Payroll taxes and withholdings	4,055,118
Voluntary termination and other related employee benefits	1,508,588
Accrued interest	80,757
Other	331,612
Total	<u>\$ 43,701,832</u>

Amount due to agencies and public corporation of the Commonwealth of Puerto Rico consist principally of liabilities for payroll tax withholdings, utilities, workmen's compensation insurance and other services.

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
 YEAR ENDED JUNE 30, 2012

6. Capital Assets

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

	<u>Balance at June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2012</u>
	<i>(Restated)</i>			
Assets not being depreciated:				
Land and improvements	\$ 2,500,000	\$ -	\$ -	\$ 2,500,000
Construction in process	5,753,781	1,050,545	(5,001,599)	1,802,727
Capital assets not being depreciated	<u>8,253,781</u>	<u>1,050,545</u>	<u>(5,001,599)</u>	<u>4,302,727</u>
Assets being depreciated:				
Buildings and improvements	19,825,789	-		19,825,789
Terminals	5,594,102			5,594,102
Transportation equipment	90,883,842	779,430	(20,618,838)	71,014,434
Machinery and equipment	23,738,921	487,050	(79,694)	24,146,277
Total	140,042,654	1,266,480	(20,728,532)	120,580,602
Less accumulated depreciation	<u>84,256,430</u>	<u>9,097,169</u>	<u>(20,733,283)</u>	<u>72,620,316</u>
Capital assets being depreciated, net	<u>55,786,224</u>	<u>(7,830,689)</u>	<u>4,751</u>	<u>47,960,286</u>
Total capital assets, net	<u>\$ 64,040,005</u>	<u>\$ (6,780,144)</u>	<u>\$ (4,996,848)</u>	<u>\$ 52,263,013</u>

During the year ended June 30, 2012 the Authority completed an analysis of its capital assets towards the implementation of a capital asset ledger. To complete the analysis the Authority analyzed capital assets records from year 2000 to present. As the result of such analysis the Authority determined that net book value of capital assets at June 30, 2010 was overstated by approximately \$2.8 million. Therefore prior years financial statements were restated for the effect of this adjustments.

7. Long-Term Debt

Long-term debt at June 30, 2012 consists of:

	<u>Balance at 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2012</u>	<u>Due Within One Year</u>
Notes payable	\$ 35,833,300	\$ -	\$ (35,833,300)	\$ -	\$ -
Notes payable	-	37,543,294	(495,242)	37,048,052	2,711,462
Total	<u>\$ 35,833,300</u>	<u>\$ 37,543,294</u>	<u>\$ (36,328,542)</u>	<u>\$ 37,048,052</u>	<u>\$ 2,711,462</u>

Effective March 2012 the Authority refinanced amounts outstanding with a private bank under a line of credit in the amount of \$3,000,000 and a long-term loan in the amount of \$34,543,294 into a long-term loan with the same bank. The new loan matures on March 2015 and is payable in monthly principal installments of \$208,574 plus interest. Interest on

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

outstanding balance is based on a margin over LIBOR based on the debt rating given to the Commonwealth of Puerto Rico's general obligations by Moddy's Corporation and Standard & Poors Financial Services LLC as defined in the agreement (2.62% at June 30, 2012). The note is secured by the assignment of the diesel tax revenues allocated by the Commonwealth of Puerto Rico.

The estimated maturities of the note payable during the next years are as follows:

Year Ending June 30,	
2013	\$ 2,711,462
2014	2,711,462
2015	<u>31,625,128</u>
Total	<u>\$37,048,052</u>

8. Noncurrent Liabilities

Changes in noncurrent liabilities, other than the notes payable described above, for the year ended June 30, 2012 are summarized as follows:

	Balance at 2011	Increases	Decreases	Balance at 2012	Due Within One Year
Compensated absences	\$ 4,529,916	\$ 4,437,724	\$ (3,346,480)	\$ 5,621,160	\$ 4,344,083
Accrued legal claims	4,270,587		(123,078)	4,147,509	-
Voluntary termination benefits	3,972,186	4,938,185	(802,225)	8,108,146	1,343,918
Other	416,963	-	(960)	416,003	161,670
Total	<u>\$ 13,189,652</u>	<u>\$ 9,375,909</u>	<u>\$ (4,272,743)</u>	<u>\$ 18,292,818</u>	<u>\$ 5,852,671</u>

9. Retirement Plan

Defined Benefit Plan

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

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

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

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

Commonwealth legislation requires that employees hired before April 1, 1990 contribute 5.775% of the first \$550 of their monthly gross salary and 8.275% of their gross monthly salary in excess of \$550. Employees hired after April 1, 1990 contribute 8.275% of their gross monthly salary. The Authority's contributions are 10.275% of the gross monthly salary. Total employer contributions during years ended June 30, 2012 amounted to approximately \$1.8 million which represented 100% of required contributions.

Defined Contribution Plan

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

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

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

The Authority's contributions of 10.275% of the employee's salary are used to fund the defined benefit plan. Total Authority's contributions during the fiscal year ended June 30, 2012 amounted to approximately \$1.3 which represented 100% of required contributions.

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

10. Commitments and Contingent Liabilities

Litigation

The Authority is involved in litigation arising in the normal course of operations. Management believes that its ultimate liability, if any, in connection with these matters will not have a material effect on the Authority's financial condition and results of operations. Due to uncertainties in the settlement process, it is at least reasonably possible that management's view of the outcome of these claims will change in the near term. Based on advice of legal counsel, management has recorded an estimated litigation and claim loss of approximately \$4.1 million as of June 30, 2012.

Federal Assistance Programs

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

Warehouse Management

During the year ended June 30, 2012 the Authority made an agreement with a private entity for services related to the administration, operation, management and control of the Authority's spare parts inventory. The agreement is due on May 2012 and the Authority will pay a maximum of approximately \$1 million for services under this contract.

11. Voluntary Termination Benefits

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEAR ENDED JUNE 30, 2012

Economic incentives are available to eligible employees who have less than 15 years of credited service in the Retirement System or who have at least 30 years of credited service in the Retirement System and the age for retirement or who have the age for retirement. Economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary based on employment years.

Additionally, eligible employees that choose to participate in the early retirement benefit program or that choose the economic incentive and have less than 15 years of credited service in the Retirement System are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Commonwealth of Puerto Rico.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately 8.1 million in the statement of net assets as of June 30, 2012 and a charge of \$5 million in the statement of activities for the year ended June 30, 2012. At June 30, 2012, unpaid long-term benefits granted on this program were discounted at 1.46%.

12. Operating Financial Assistance from the Commonwealth of Puerto Rico

As shown in the accompanying financial statements, the Authority has incurred in accumulated losses after operating and capital contributions in the amount of \$77.6 million and as of June 30, 2012 the Authority's liabilities exceeded its assets by approximately \$25.3 million. In addition, at June 30, 2012 the Authority has a working capital deficiency of approximately \$31.4 million making it difficult for the Authority to pay its liabilities in the normal course of business. These facts indicate that the Authority needs the continued support from the Commonwealth of Puerto Rico in the form of operating grants to continue to operate at its present level and to continue as a going concern. The Commonwealth of Puerto Rico has experienced budget constraints during the current and prior years which have resulted in reductions in the operating grants provided to the Authority. Management believes that since the transportation service provided by the Authority is an essential service to the people of Puerto Rico, the Commonwealth of Puerto Rico will continue to fund the operational deficits incurred by the Authority. Any significant reduction in these operating grants and financial support will affect the ability of the Authority to provide the transportation services and to continue as a going concern.

13. Other Post-Employment Benefits

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