



PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required
Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

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KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Board of Directors
Puerto Rico Tourism Company:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund, and the aggregate remaining fund information of the Puerto Rico Tourism Company (the Company), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Company'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 financial statements in accordance with U.S. generally accepted accounting principles; 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.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. 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 auditors' 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 entity'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 entity'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 opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business type activities, each major fund, and the aggregate remaining fund information of the Puerto Rico Tourism Company as of June 30, 2013, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.



Other Matters

Restatement of Net Position and Fund Balance

As part of our audit of the 2013 basic financial statements we also audited the adjustments described in Note 2 that were applied to restate net position and fund balance as of July 1, 2012. The Company's previously issued basic financial statements were audited by other auditors. In our opinion, such adjustments are appropriate and have been properly applied.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 15 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 management's discussion and analysis 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.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Company's basic financial statements. The combining schedules included as other information on pages 66 and 67 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the combining schedules are fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

San Juan, Puerto Rico
March 24, 2014

Stamp No. E94603 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2013



As management of the Puerto Rico Tourism Company (the Company), we offer readers of these basic financial statements our discussion and analysis of the Company's financial performance during the fiscal year that ended on June 30, 2013. Please read the information presented in this section in conjunction with the Company's basic financial statements, including the notes thereto, which follow this section.

This discussion and analysis is intended to serve as an introduction to the Company's basic financial statements, which comprise the following components: (1) Government-Wide Financial Statements, composed of (i) statement of net position and (ii) statement of activities; (2) Governmental Fund Financial Statements, composed of the General Fund and the capital projects Fund, including (i) balance sheet, (ii) reconciliation of the balance sheet to the statement of net position, (iii) statement of revenues, expenditures, and changes in fund balances, and (iv) reconciliation of the statement of revenues, expenditures, and changes in fund balances to the statement of activities; (3) Proprietary Fund Financial Statements, composed of two proprietary funds, including (i) statement of net position, (ii) statement of revenues, expenses, and changes in fund net position, and (iii) statement of cash flows; and (4) notes to basic financial statements.

Financial Highlights

- The Company's governmental activities reflect an increase in the net position of approximately \$9.2 million during the year ended June 30, 2013.
- Hotel room tax and slot machines operations revenues amounted to approximately \$65.6 million and \$163.3 million, respectively, for the year ended June 30, 2013. This represents an increase in hotel room tax revenue and a decrease in slot machines operations revenues of approximately \$7.2 million and \$5.5 million, respectively, when compared to the year ended June 30, 2012.
- The Company incurred \$41.6 million in expenses to promote Puerto Rico as a premier international tourist destination.
- The Hotel Development Corporation, (HDC), a blended component unit of the Company, received \$1.0 million from Puerto Rico Sales Tax Financing Corporation for the payment of interest accrued on notes payable.

Overview of the Financial Statements

The basic financial statements of the Company are prepared in conformity with U.S. generally accepted accounting principles as applicable to governmental entities. Accordingly, the basic financial statements include two kinds of statements that present different views of the Company:

- The first two statements are government-wide financial statements that provide both short- and long-term information about the Company's overall financial position and results of operations. These statements are

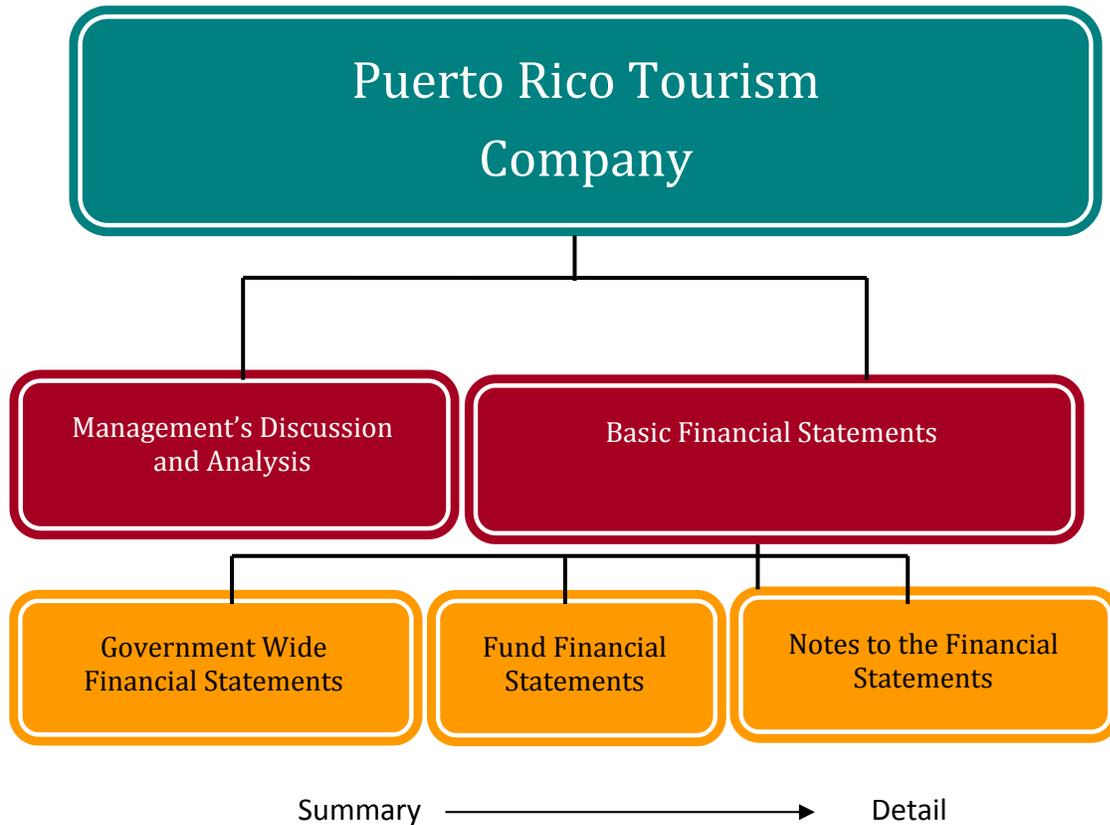
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presented on the accrual basis of accounting and comprise a statement of net position and a statement of activities.

- The remaining statements are fund financial statements that focus on individual parts of the Company's government, thus reporting the Company's operations in more detail than the government-wide financial statements. The governmental funds statements show how services, such as promotional activities and tourism development, were financed in the short term as well as what remains for future spending. Proprietary funds statements offer short- and long-term financial information about the activities in which the government operates similar to private sectors companies.

The notes to the basic financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes are an integral part of the basic financial statements.

Required Components of Annual Financial Report



PUERTO RICO TOURISM COMPANY
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Government-Wide Financial Statements

The government-wide financial statements report information about the Company as a whole using accounting methods similar to those used by private-sector companies. The statement of net position includes all of the government's assets and liabilities. Net position is composed of three categories: net investment in capital assets, restricted, or unrestricted. Restricted amounts are further classified as either net position restricted by enabling legislation or net position as otherwise restricted. All of the current year's revenue and expenses are accounted for in the statement of activities, regardless of when cash is received or paid. All changes in net position are reported as soon as the underlying event gives rise to the change that occurs, regardless of the timing of the related cash flows. The government-wide financial statements report the Company's net position and how they have changed. Net position is one of the measures of the Company's financial health or position.

Increases or decreases in the Company's net position are indicators of whether its financial health is improving or deteriorating. To assess the overall health of the Company, the reader needs to consider additional nonfinancial factors, such as increased competition for tourism industries of other Latin American and Caribbean locations.

The government-wide financial statements of the Company are divided into two categories:

- Governmental activities – Most of the Company's basic services, such as tourism promotions, development, general administration, regulation of gaming, tourism-related transportation services, and other related regulatory matters are included herein. These activities are mainly financed through hotel room taxes, legislative appropriations from the Commonwealth of Puerto Rico (the Commonwealth), and transfers from the slot machines operations.
- Business-type activities – The Company charges fees to the hotels and other administrators of gaming activities in Puerto Rico. Such fees are substantially based on parameters established by law, taking into consideration the Company's regulatory and oversight activities for the slot machines operations.

Fund Financial Statements

Funds are groupings of related accounts that the Company uses to keep track of specific sources of funding and spending for particular purposes. The Company has two kinds of funds:

- Governmental funds – Most of the Company's basic services are included in governmental funds, which focus on (1) how cash and other financial assets can readily be converted to cash flows in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed short-term view that help readers determine whether there are more or fewer financial resources that can be spent in the near future to finance the Company's programs. Because this information does not encompass the additional long-term focus of government-wide statements, we provide additional information as a separate statement following the applicable fund statement that explains the relationship (or differences) between them.
- Proprietary funds – Services for which the Company charges users a fee are reported in the proprietary funds. Proprietary funds provide both long- and short-term financial information. In fact, the Company's enterprise funds (one type of proprietary fund) are the same as its business-type activities, but provide more detail and additional information, such as cash flows.

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Government-Wide Financial Analysis

The following is an analysis of the financial position and changes in financial position of the Company's governmental and business-type activities:

Governmental Activities

Condensed financial information of governmental activities in the statement of net position as of June 30, 2013 and 2012 is as follows:

	<u>As of June 30</u>		<u>Increase (decrease)</u>	<u>Variance percentage</u>
	<u>2013</u>	<u>2012</u> (As restated)		
Assets:				
Current assets	\$ 30,479,835	36,004,982	(5,525,147)	(15)%
Capital assets	32,058,583	33,978,311	(1,919,728)	6
Noncurrent assets	29,197,610	26,571,071	2,626,539	10
Total assets	<u>91,736,028</u>	<u>96,554,364</u>	<u>(4,818,336)</u>	(15)
Liabilities:				
Current liabilities	56,738,316	77,377,629	(20,639,313)	(27)
Noncurrent liabilities	28,831,222	22,232,073	6,599,149	29
Total liabilities	<u>85,569,538</u>	<u>99,609,702</u>	<u>(14,040,164)</u>	(14)
Net position:				
Net investment in capital assets	31,992,522	33,724,882	(1,732,360)	(5)
Restricted	3,717,689	3,717,689	—	—
Unrestricted (deficit)	(29,543,721)	(40,497,909)	10,954,188	26
Total net position (deficit)	<u>\$ 6,166,490</u>	<u>(3,055,338)</u>	<u>9,221,828</u>	(85)

As of June 30, 2013, total assets of governmental activities amounted to approximately \$91.7 million and total liabilities amounted to approximately \$85.6 million, for net position of approximately \$6.2 million. Net position reflects an increase of approximately \$9.2 million, when compared to prior year.

Net position has been broken down into net investment in capital assets, of approximately \$32.0 million; restricted net position of approximately \$3.7 million; and a deficit of approximately \$29.5 million. Restricted net position is for debt service.

The net investment in capital assets decreased by approximately \$1.7 million due to the sale of Escuela Hotelera. Unrestricted net position (deficit) increased by approximately \$11.0 million primarily because of a decrease in program expenses of approximately \$13.9 million.

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Total liabilities decreased by approximately \$14.0 million during 2013 mainly due to the net effect of an increase of approximately \$7.4 million of open invoices, draws from the Company's line of credit of \$4.5 million, a decrease of approximately \$22.3 million in internal balances, and an increase of \$1.9 million in the liability for termination benefits. The borrowings from the line of credit were mainly used to fund the Hotel Development Corporation (HDC)'s investments in and loans for the development of tourism projects. The increase in the liability for termination benefits is the result of the implementation of the Company's early retirement program.

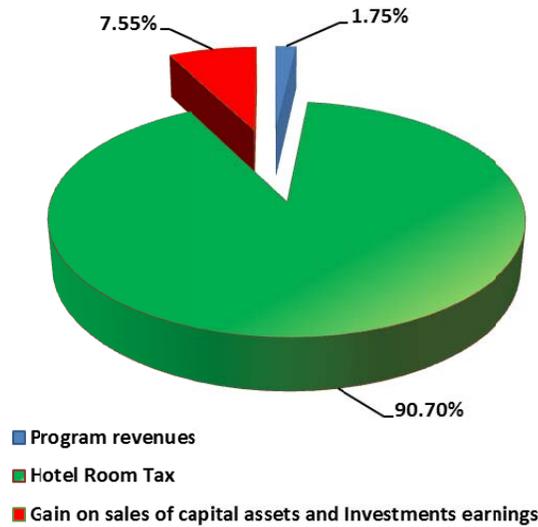
Condensed financial information of governmental activities in the statement of activities for the years ended June 30, 2013 and 2012 is shown below:

	<u>Year ended June 30</u>		<u>(Decrease)</u> <u>increase</u>	<u>Variance</u> <u>percentage</u>
	<u>2013</u>	<u>2012</u> <u>(As restated)</u>		
Program revenues:				
Operating grants and contributions	\$ 25,000	300,000	(275,000)	(92)%
Charges for services	1,244,084	840,088	403,996	48
Total program revenues	<u>1,269,084</u>	<u>1,140,088</u>	<u>128,996</u>	11
General revenues:				
Hotel room taxes	65,641,949	58,468,172	7,173,777	12
Gain (loss) on sales of capital assets	5,084,589	(750,000)	5,834,589	778
Investment earnings	375,946	523,965	(148,019)	(28)
Total general revenues	<u>71,102,484</u>	<u>58,242,137</u>	<u>12,860,347</u>	22
Total revenues	<u>72,371,568</u>	<u>59,382,225</u>	<u>12,989,343</u>	22
Functions/programs:				
General government	72,613,337	75,604,488	(2,991,151)	(4)
Advertising and promotion	41,629,172	52,020,494	(10,391,322)	(20)
Programs and services	2,117,974	1,739,478	378,496	22
Public relations	2,287,021	3,214,769	(927,748)	(29)
Total functions/programs	<u>118,647,504</u>	<u>132,579,229</u>	<u>(13,931,725)</u>	(11)
Net expenses before transfers	(46,275,936)	(73,197,004)	26,921,068	37
Transfers	55,497,764	54,172,551	1,325,213	2
Change in net position	9,221,828	(19,024,453)	28,246,281	148
Net position (deficit) – beginning of year	<u>(3,055,338)</u>	<u>15,969,115</u>	<u>(19,024,453)</u>	(119)
Net position (deficit) – end of year	<u>\$ 6,166,490</u>	<u>(3,055,338)</u>	<u>9,221,828</u>	302

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The following chart summarizes the Company's revenues by sources for the governmental activities for the fiscal year ended June 30, 2013.

Revenues by Source - Governmental Activities



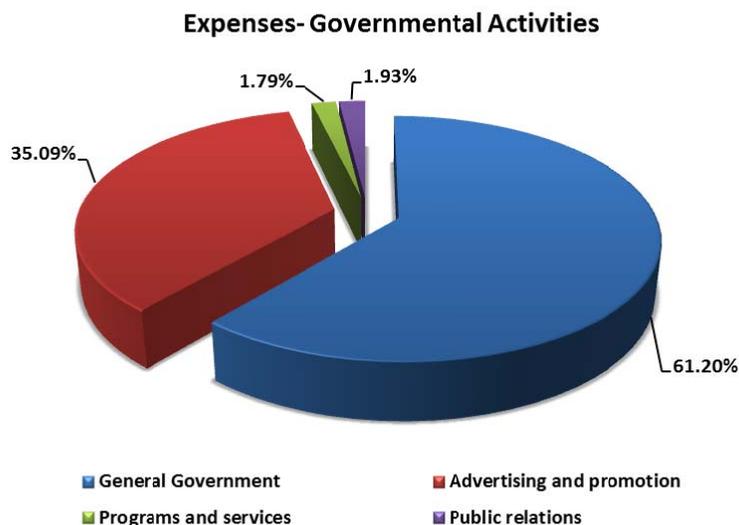
Hotel room taxes revenue increased approximately \$7.2 million as a result of new hotels and luxury hotels that opened facilities during 2013 and the increase in the volume of the rooms occupied. Also, during 2013, the increase in total revenues of approximately \$13.0 million included a gain on sale of Escuela Hotelera of approximately \$5.1 million.

General government expenses decreased approximately by \$3.0 million due to the budget plan established for the year ended June 30, 2013 directed towards reduction of general and administrative expenses.

Advertising and promotion expenses decreased approximately \$10.4 million because the Company changed its advertising and promotion companies, and revisited its advertising programs, resulting in significant savings in this area. Also, there were certain special activities that took place during fiscal year 2012 did not occur during fiscal year 2013.

The following chart summarizes the Company's function/programs expenses for the governmental activities for the fiscal year ended June 30, 2013.

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Business-Type Activities

Condensed financial information of business-type activities in the statement of net position as of June 30, 2013 and 2012 is as follows:

	As of June 30		Increase (decrease)	Variance percentage
	2013	2012 (As restated)		
Assets:				
Current assets	\$ 6,384,925	6,505,299	(120,374)	(2)%
Capital assets	3,516	42,021	(38,505)	(92)
Other noncurrent assets	5,367,560	27,162,141	(21,794,581)	(80)
Total assets	<u>11,756,001</u>	<u>33,709,461</u>	<u>(21,953,460)</u>	<u>(65)</u>
Liabilities:				
Current liabilities	245,589	(153,284)	398,873	260
Noncurrent liabilities	47,012,471	46,286,469	726,002	2
Total liabilities	<u>47,258,060</u>	<u>46,133,185</u>	<u>1,124,875</u>	<u>2</u>
Net position:				
Net investment in capital assets	3,516	42,021	(38,505)	(92)
Unrestricted (deficit)	<u>(35,505,575)</u>	<u>(12,465,745)</u>	<u>(23,039,830)</u>	<u>(185)</u>
Total net position (deficit)	<u>\$ (35,502,059)</u>	<u>(12,423,724)</u>	<u>(23,078,335)</u>	<u>(186)</u>

Business-type activities include the HDC Fund and Slot Machines Operations Fund. Total assets decreased approximately \$22.0 million, from \$33.7 million as of June 30, 2012 to \$11.8 million as of June 30, 2013. The

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Management's Discussion and Analysis (Unaudited)

June 30, 2013

decrease is mainly due to impairment adjustments on the investment in tourism projects of approximately \$28.0 million.

Condensed financial information of business-type activities in the statement of activities for the years ended June 30, 2013 and 2012 is shown below:

	<u>Year ended June 30</u>		<u>Increase (decrease)</u>	<u>Variance percentage</u>
	<u>2013</u>	<u>2012</u> (As restated)		
Program revenues:				
Operating grants and contributions	\$ 1,048,235	24,649,025	(23,600,790)	(96)%
Charges for services – financing and investing	3,531,855	396,300	3,135,555	791
Charges for services – other	<u>163,280,338</u>	<u>168,815,518</u>	<u>(5,535,180)</u>	(3)
Total program revenues	<u>167,860,428</u>	<u>193,860,843</u>	<u>(26,000,415)</u>	(13)
Functions/programs:				
Hotel Development Corporation	30,963,034	61,984,805	(31,021,771)	(50)
Slot Machines Operations	<u>104,477,965</u>	<u>107,360,995</u>	<u>(2,883,030)</u>	(3)
Total functions/programs	<u>135,440,999</u>	<u>169,345,800</u>	<u>(33,904,801)</u>	(21)
Net revenues before transfers	32,419,429	24,515,043	7,904,386	32
Transfers	<u>(55,497,764)</u>	<u>(54,172,551)</u>	<u>(1,325,213)</u>	80
Change in net position	(23,078,335)	(29,657,508)	6,579,173	22
Net position (deficit) – beginning of year	<u>(12,423,724)</u>	<u>17,233,784</u>	<u>(29,657,508)</u>	(172)
Net position (deficit) – end of year	<u>\$ (35,502,059)</u>	<u>(12,423,724)</u>	<u>(23,078,335)</u>	(186)

Total revenues decreased by approximately \$26.0 million during the year ended June 30, 2013, mainly because in 2012 the Company received \$22 million from the Puerto Rico Sales Tax Financing Corporation that was used to repay principal and interest on notes payable. For 2013, this transaction did not occur. Also, there was a decrease of approximately \$5.5 million in revenue from slot machines operations.

Total expenses decreased by approximately \$33.9 million mainly due to the net effect of a decrease in the provision for losses on loans receivable of approximately \$39.7 million; an increase in the impairment losses of tourism projects of approximately \$14.2 million and the decrease in interest expense of approximately \$3.9 million.

Analysis of Fund Financial Statements

The Company has one major governmental fund (the General Fund), one non-major governmental fund (the capital projects fund) and two major proprietary funds (the Hotel Development Corporation and the Slot Machine

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Operations). The following is an analysis of the financial position and changes in financial position by major fund.

General Fund

General Fund's assets at June 30, 2013, consist substantially of cash and cash equivalents of approximately \$13.9 million, investments of approximately \$37.9 million, and accounts receivable of approximately \$6.4 million. The Company pools all of its cash and investments in the General Fund and, as a result, the General Fund owes approximately \$11.2 million to the proprietary funds. Fund balance increased by approximately \$21.6 million when compared to the previous year.

Cash decreased approximately \$8.9 million, from \$22.8 million to \$13.9 million, due to the net effect of decrease in collections from slot machines operations and the increase of collections from hotel room tax. Hotel room taxes receivables, net of uncollectible amounts, increased approximately \$700 thousand, from \$5.2 million to \$5.9 million as a result of the increase in hotel room taxes receivables and the provision for uncollectible accounts of approximately \$2.9 million and \$2.0 million, respectively. The increase in hotel room taxes receivable is in line with the increase in related revenue fueled by an increase in occupancy rates and new hotel facilities during 2013.

Accounts payable increased by approximately by \$7.4 million, from \$17.3 million in 2012 to \$24.7 million in 2013 due to open invoices recorded as of June 30, 2013 and unremitted distributions to participants of slot machines operations, the Commonwealth of Puerto Rico and the University of Puerto Rico.

Other liabilities increased by approximately \$2.2 million, from \$631 thousand in 2012 to \$2.8 million in 2013 as a result of \$2.1 million of unremitted distributions to the Puerto Rico National Parks Company.

Revenue from hotel room taxes increased approximately by \$5.1 million, from \$60.6 million in 2012 to \$65.6 million in 2013 due to new hotels and luxury hotels opening their facilities during 2013 and the increase in occupancy.

General government expenditures decreased approximately by \$930 thousand, from \$70.3 million in 2012 to \$69.4 million in 2013 due to the budget plan established for the year ended June 30, 2013.

Meanwhile, advertising and promotion expenditures decreased approximately \$10.4 million, from \$52.0 million in 2012 to \$41.6 million because the advertising and promotions activities were reduced during the third and fourth quarters of the year ended June 30, 2013 as a result of changes in the advertising agencies used by the Company.

During the year, the Company used approximately \$4.5 million from its line of credit facilities primarily to finance HDC investments and loans in tourism projects.

The General Fund received \$58.8 million of the total transfer from the Slot Machines Operations Fund.

Hotel Development Corporation (HDC) Fund

HDC Fund's assets at June 30, 2013, consist primarily of cash and cash equivalents of approximately \$552 thousand, investment in tourism projects of approximately \$3.9 million and a balance due from the

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Commonwealth of approximately \$2.3 million. Total liabilities consist of interest payable of approximately \$899 thousand, and notes payable of approximately \$43.6 million. Fund deficit increased approximately \$23.1 million when compared to the previous year.

Cash decreased by approximately \$2.0 million, from \$2.5 million to \$552 thousand, because the Fund did not receive sufficient cash flows from its activities during 2013.

Investment in tourism projects decreased by approximately \$22.2 million, from \$26.1 million to \$3.9 million as a result of the net effect of an impairment adjustment recorded on tourism projects.

Total operating revenues increased by approximately \$2.4 million from \$1.1 million to \$3.5 million, mainly due to an increase of \$1.1 million related to the sale of investment tax credits of the investment in tourism projects and to the realization of approximately \$1.7 million of rent receivables that were fully reserved in previous years.

Total operating expenses decreased by approximately \$27.3 million, from \$55.7 million to \$28.4 million, mainly due to a decrease in the provision for losses on loans receivables, an increase in impairment losses on tourism projects, and a decrease in interest expense of approximately \$39.7 million, \$13.9 million, and \$3.9 million, respectively.

Total nonoperating revenues (expenses) decreased by approximately \$19.0 million from \$18.5 million to \$(1.5) million, due to a decrease of contributions received from the Puerto Rico Sales Tax Financing Corporation for the repayment of principal and interest on notes payable.

Slot Machines Operations Fund

Slot Machines Operations Fund's assets at June 30, 2013, consist primarily of accounts receivable of approximately \$2.6 million, and due from other fund of approximately \$11.2 million. Total liabilities consist of unremitted distributions to the Commonwealth of Puerto Rico, the University of Puerto Rico, and Participants of Slot Machines Operations of approximately \$1.9 million, \$5.8 million, and \$2.1 million, respectively, and accrued compensated absences of approximately \$3.0 million.

Accounts receivable increased by approximately \$1.1 million, from \$1.5 million to \$2.6 million, due to collections from slot machines operations' participants that were not received as of June 30, 2013.

Due from other fund decreased by approximately \$22.3 million, from \$33.5 million to \$11.2 million, due to the Slot Machines Operations Fund transfer of funds to the General Fund to pay the June's distributions to the Commonwealth of Puerto Rico, the University of Puerto Rico, and Participants of Slot Machines Operations. As a result of this interfund transfer, the unremitted distributions to the Commonwealth of Puerto Rico, the University of Puerto Rico, and Participants of Slot Machines Operations decreased approximately \$22.0 million, from \$31.8 million to \$9.8 million.

Total operating revenues decreased approximately by \$5.5 million, from \$168.8 million to \$163.3 million, mainly due to the closing of local hostelry casinos and a reduction of the hourly operation in various casinos.

Total nonoperating expenses (distributions to the Commonwealth of Puerto Rico and the University of Puerto Rico) decreased approximately by \$4.1 million, from \$94.5 million to \$90.4 million as a result of the decrease in operating revenues.

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Interfund transfers to the General Fund decreased by approximately \$2.7 million, from \$61.5 million to \$58.8 million, as a result of the decrease in operating revenues.

Capital Assets

The Company's capital assets as of June 30, 2013 and 2012 amounted to approximately \$32.1 million and \$34.0 million, respectively, net of accumulated depreciation. Capital assets included land, works of art, infrastructure, buildings and improvements, leasehold improvements, furniture and equipment, and vehicles. The decrease from 2012 results primarily from the sale of Escuela Hotelera. See note 10 to the basic financial statements for additional details on capital assets at year-end and on activity during the fiscal year.

Long-Term Debt

Significant long-term debt activity during fiscal year 2013 was as follows:

- Long-term debt in the governmental activities amounted to approximately \$28.8 million as of June 30, 2013. Long-term debt consists primarily of borrowings under a line of credit of approximately \$16.1 million, termination benefits of approximately \$7.3 million, and accrued compensated absences of approximately \$3.9 million.
- Long-term debt in the business-type activities amounted to approximately \$47.0 million as of June 30, 2013 and consisted primarily of a long-term note payable to the Puerto Rico Public Finance Corporation for approximately \$43.6 million and accrued compensated absences of approximately \$3.0 million.

During the year, the Company used the line of credit to invest in tourism projects and make loans to tourism projects.

See note 11 to the basic financial statements for additional analysis and activity of long-term debt of the Company.

Economic Factors

During the first ten months of fiscal year 2013, the number of persons registered in tourist hotels, including residents of Puerto Rico and tourists, was approximately 1.8 million, an increase of 5.5% over the number of persons registered during the same period of fiscal year 2012. The average occupancy rate in tourist hotels during the first ten months of fiscal year 2013 was 72.4%, an increase of 3.9% from the prior fiscal year. Also, during the first ten months of fiscal year 2013, the average number of rooms available in tourist hotels increased by approximately 1.8% to 12,000 rooms compared to the same period of fiscal year 2012.

According to the Payroll Survey, employment in the leisure and hospitality sector was approximately 73,000 for fiscal year 2012, an increase of 2.1% over employment for fiscal year 2011, a growth rate significantly smaller than the growth rates of tourist hotel registrations for the same time period (9.4%). Moreover, for fiscal year 2013, employment in this sector increased by 3.5% to approximately 75,000 compared to the same period of the prior fiscal year, which is still a smaller rate than the average growth rate observed for the first ten months on the tourist hotel registrations (5.5%). These figures could imply a significant improvement on the labor productivity of this sector during fiscal years 2012 and 2013.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Management's Discussion and Analysis (Unaudited)

June 30, 2013

San Juan is the largest homeport for cruise ships in the Caribbean and one of the largest homeports for cruise ships in the world.

Tourism Data⁽¹⁾
Number of Visitors

	Tourist			Total
	Hotels⁽²⁾	Excursionists⁽³⁾	Other⁽⁴⁾	
Fiscal year ended June 30:				
2008	1,342,810	1,496,853	2,372,436	5,212,099
2009	1,277,749	1,232,010	1,905,503	4,415,262
2010	1,349,449	1,193,549	1,777,070	4,320,068
2011	1,408,536	1,165,758	1,539,931	4,114,225
2012 ⁽⁵⁾	1,507,984	1,127,842	1,561,103	4,196,929

Total Visitors' Expenditures
(In millions)

	Tourist			Total
	Hotels⁽²⁾	Excursionists⁽³⁾	Other⁽⁴⁾	
Fiscal year ended June 30:				
2008	\$ 1,526.3	194.3	1,814.3	3,534.9
2009	1,464.4	173.7	1,537.7	3,175.8
2010	1,541.8	171.4	1,497.5	3,210.7
2011	1,618.9	169.3	1,354.6	3,142.8
2012 ⁽⁵⁾	1,706.9	167.7	1,318.3	3,192.9

⁽¹⁾ Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.

⁽²⁾ Includes visitors in guesthouses.

⁽³⁾ Includes cruise ship visitors and transient military personnel.

⁽⁴⁾ Includes visitors in homes of relatives, friends, and in hotel apartments.

⁽⁵⁾ Preliminary.

Sources: Puerto Rico Tourism Company and the Planning Board.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2013

Request for Information

This financial report is designed to provide a general overview of the Company for all those with an interest in the Company's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, Puerto Rico Tourism Company, Tanca Street #500, Ochoa Building 3rd Floor, Old San Juan, San Juan, PR, 00902-3960.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Position

June 30, 2013

Assets	Governmental activities	Business-type activities	Total
Cash and cash equivalents	\$ 13,901,450	551,844	14,453,294
Investments	37,945,255	—	37,945,255
Accounts receivable:			
Hotel room taxes – net	5,907,327	—	5,907,327
Hotels and casinos	—	4,380,264	4,380,264
Other	504,062	—	504,062
Prepaid expenses and other assets	69,351	—	69,351
Due from Commonwealth of Puerto Rico	—	2,314,891	2,314,891
Accrued return on investment	—	176,104	176,104
Investment in tourism projects	—	3,899,963	3,899,963
Notes and loans receivable – net	1,350,000	15,311	1,365,311
Deferred debt issue costs	—	414,108	414,108
Capital assets:			
Land and works of art	12,542,529	—	12,542,529
Infrastructure, buildings, improvements, furniture and equipment, and vehicles, net of accumulated depreciation	19,516,054	3,516	19,519,570
Total assets	91,736,028	11,756,001	103,492,029
Liabilities			
Unremitted distributions of slot machines operations to:			
Commonwealth of Puerto Rico	—	1,948,954	1,948,954
University of Puerto Rico	—	5,771,003	5,771,003
Participants of slot machines operations	—	2,077,792	2,077,792
Accounts payable	24,703,964	739,413	25,443,377
Unearned revenue	7,503,774	—	7,503,774
Other liabilities	2,773,907	—	2,773,907
Interest payable	—	899,051	899,051
Due to Puerto Rico Convention Center District Authority	4,177,949	—	4,177,949
Due to Commonwealth of Puerto Rico	6,388,098	—	6,388,098
Internal balances	11,190,624	(11,190,624)	—
Long-term obligations due within one year:			
Line of credit	16,113,931	—	16,113,931
Other accrued long-term liabilities	2,067,466	764,451	2,831,917
Long-term obligations due in more than one year:			
Notes payable	—	43,562,119	43,562,119
Other accrued long-term liabilities	10,649,825	2,685,901	13,335,726
Total liabilities	85,569,538	47,258,060	132,827,598
Net Position			
Net investment in capital assets	31,992,522	3,516	31,996,038
Restricted for debt service	3,717,689	—	3,717,689
Unrestricted (deficit)	(29,543,721)	(35,505,575)	(65,049,296)
Total net position (deficit)	\$ 6,166,490	(35,502,059)	(29,335,569)

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Activities

Fiscal year ended June 30, 2013

Functions/programs	Expenses	Program revenues			Net (expenses) revenues and changes in net position		
		Charges for services – other	Charges for services – financing and investing	Operating grants and contributions	Governmental activities	Business-type activities	Total
Governmental activities:							
General government	\$ 72,613,337	1,244,084	—	25,000	(71,344,253)	—	(71,344,253)
Advertising and promotion	41,629,172	—	—	—	(41,629,172)	—	(41,629,172)
Programs and services	2,117,974	—	—	—	(2,117,974)	—	(2,117,974)
Public relations	2,287,021	—	—	—	(2,287,021)	—	(2,287,021)
Total governmental activities	<u>118,647,504</u>	<u>1,244,084</u>	<u>—</u>	<u>25,000</u>	<u>(117,378,420)</u>	<u>—</u>	<u>(117,378,420)</u>
Business-type activities:							
Hotel Development Corporation	30,963,034	—	3,531,855	1,048,235	—	(26,382,944)	(26,382,944)
Slot machines operations	104,477,965	163,280,338	—	—	—	58,802,373	58,802,373
Total business-type activities	<u>135,440,999</u>	<u>163,280,338</u>	<u>3,531,855</u>	<u>1,048,235</u>	<u>—</u>	<u>32,419,429</u>	<u>32,419,429</u>
	<u>\$ 254,088,503</u>	<u>164,524,422</u>	<u>3,531,855</u>	<u>1,073,235</u>	<u>(117,378,420)</u>	<u>32,419,429</u>	<u>(84,958,991)</u>
General revenues:							
Hotel room taxes					65,641,949	—	65,641,949
Gain on sales of capital assets					5,084,589	—	5,084,589
Unrestricted investments' earnings					375,946	—	375,946
Transfers in (out) – net					55,497,764	(55,497,764)	—
Total general revenues and transfers					<u>126,600,248</u>	<u>(55,497,764)</u>	<u>71,102,484</u>
Change in net position					9,221,828	(23,078,335)	(13,856,507)
Net position (deficit) – beginning of year (as restated, see Note 2)					<u>(3,055,338)</u>	<u>(12,423,724)</u>	<u>(15,479,062)</u>
Net position (deficit) – end of year					<u>\$ 6,166,490</u>	<u>(35,502,059)</u>	<u>(29,335,569)</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Governmental Funds
Balance Sheet
June 30, 2013

Assets	<u>General</u>	<u>Nonmajor fund – capital projects</u>	<u>Total governmental funds</u>
Cash and cash equivalents	\$ 13,901,450	—	13,901,450
Investments	37,945,255	—	37,945,255
Accounts receivable:			
Hotel room taxes – net	5,907,327	—	5,907,327
Other	504,062	—	504,062
Prepaid expenses and other assets	69,351	—	69,351
Note receivable	<u>1,350,000</u>	<u>—</u>	<u>1,350,000</u>
Total assets	<u>\$ 59,677,445</u>	<u>—</u>	<u>59,677,445</u>
Liabilities and Fund Balances			
Liabilities:			
Accounts payable	\$ 24,703,964	—	24,703,964
Unearned revenue	7,503,774	—	7,503,774
Other liabilities	2,773,907	—	2,773,907
Due to Puerto Rico Convention Center District Authority	4,177,949	—	4,177,949
Due to Commonwealth of Puerto Rico	6,388,098	—	6,388,098
Due to other funds	<u>11,190,624</u>	<u>—</u>	<u>11,190,624</u>
Total liabilities	<u>56,738,316</u>	<u>—</u>	<u>56,738,316</u>
Fund balances:			
Nonspendable	1,419,351	—	1,419,351
Restricted	3,717,689	—	3,717,689
Committed	31,604,572	—	31,604,572
Unassigned (deficit)	<u>(33,802,483)</u>	<u>—</u>	<u>(33,802,483)</u>
Total fund balances	<u>2,939,129</u>	<u>—</u>	<u>2,939,129</u>
Total liabilities and fund balances	<u>\$ 59,677,445</u>	<u>—</u>	<u>59,677,445</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Governmental Funds

Reconciliation of the Balance Sheet to the Statement of Net Position

June 30, 2013

Total fund balances - governmental funds	\$ 2,939,129
Amounts reported for governmental activities in the statement of net position are different because:	
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds	32,058,583
Certain liabilities are not due and payable in the current period and, therefore, are not reported in the funds:	
Line of credit	(16,113,931)
Capital lease obligations	(66,061)
Accrued Christmas bonus	(911,001)
Accrued legal claims	(561,004)
Accrued termination benefits	(7,305,978)
Accrued compensated absences	(3,873,247)
Net position of governmental activities	\$ <u><u>6,166,490</u></u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Governmental Funds
Statement of Revenues, Expenditures, and Changes in Fund Balances

Fiscal year ended June 30, 2013

	General	Nonmajor fund – capital projects	Total governmental funds
Revenues:			
Hotel room taxes	\$ 65,641,949	—	65,641,949
Commonwealth of Puerto Rico appropriations	25,000	—	25,000
Charges for programs and services	1,244,084	—	1,244,084
Investment earnings	375,946	—	375,946
Total revenues	<u>67,286,979</u>	<u>—</u>	<u>67,286,979</u>
Expenditures:			
Current:			
General government	69,385,303	—	69,385,303
Advertising and promotion	41,629,172	—	41,629,172
Programs and services	2,117,974	—	2,117,974
Public relations	2,287,021	—	2,287,021
Capital outlays – general government	113,042	—	113,042
Total expenditures	<u>115,532,512</u>	<u>—</u>	<u>115,532,512</u>
Deficiency of revenues over expenditures	<u>(48,245,533)</u>	<u>—</u>	<u>(48,245,533)</u>
Other financing sources (uses):			
Proceeds from line of credit	4,544,025	—	4,544,025
Sales of capital assets	5,944,446	—	5,944,446
Transfers in	62,652,154	—	62,652,154
Transfers out	(3,304,609)	(3,849,781)	(7,154,390)
Total other financing sources – net	<u>69,836,016</u>	<u>(3,849,781)</u>	<u>65,986,235</u>
Net change in fund balances	21,590,483	(3,849,781)	17,740,702
Fund balances (deficit) – beginning of year (as restated, see Note 2)	<u>(18,651,354)</u>	<u>3,849,781</u>	<u>(14,801,573)</u>
Fund balances – end of year	<u>\$ 2,939,129</u>	<u>—</u>	<u>2,939,129</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Governmental Funds

Reconciliation of the Statement of Revenues, Expenditures,
and Changes in Fund Balances to the Statement of Activities

Fiscal year ended June 30, 2013

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

Net change in fund balances - total governmental funds	\$ 17,740,702
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which depreciation expense (\$1,158,741) exceeds capital outlays (\$113,042) in the current period.	(1,045,699)
Loss on disposal of capital assets. Capital assets used in governmental activities are not reported in the fund financial statements and do not enter in the determination of gain or loss on sale of assets.	(874,029)
The issuance of long-term debt provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. This is the amount by which the issuance of long-term debt exceeds the repayment of principal in the current period:	
Draws on line of credit	(4,544,025)
Capital lease repayments	187,368
Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds:	
Christmas bonus	133,735
Legal claims	(257,604)
Termination benefits	(1,195,852)
Compensated absences	(922,768)
Changes in net position of governmental activities	\$ <u>9,221,828</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Proprietary Funds
Statement of Net Position

June 30, 2013

Assets	Hotel Development Corporation	Slot Machines Operations	Total
Current assets:			
Cash and cash equivalents	\$ 551,844	—	551,844
Accounts receivable – net	1,743,183	2,637,081	4,380,264
Loans receivable – net	15,311	—	15,311
Due from Commonwealth of Puerto Rico	1,437,506	—	1,437,506
Due from other fund	—	11,190,624	11,190,624
Total current assets	<u>3,747,844</u>	<u>13,827,705</u>	<u>17,575,549</u>
Noncurrent assets:			
Due from Commonwealth of Puerto Rico	877,385	—	877,385
Accrued return on investment	176,104	—	176,104
Investment in tourism projects	3,899,963	—	3,899,963
Deferred debt issue costs	414,108	—	414,108
Capital assets – net	—	3,516	3,516
Total noncurrent assets	<u>5,367,560</u>	<u>3,516</u>	<u>5,371,076</u>
Total assets	<u>9,115,404</u>	<u>13,831,221</u>	<u>22,946,625</u>
Liabilities			
Current liabilities:			
Unremitted distributions to:			
Commonwealth of Puerto Rico	—	1,948,954	1,948,954
University of Puerto Rico	—	5,771,003	5,771,003
Participants of Slot Machines Operations	—	2,077,792	2,077,792
Accounts payable	156,293	583,120	739,413
Interest payable	899,051	—	899,051
Accrued compensated absences	—	274,680	274,680
Christmas bonus	—	489,771	489,771
Total current liabilities	<u>1,055,344</u>	<u>11,145,320</u>	<u>12,200,664</u>
Noncurrent liabilities:			
Notes payable	43,562,119	—	43,562,119
Accrued compensated absences	—	2,685,901	2,685,901
Total noncurrent liabilities	<u>43,562,119</u>	<u>2,685,901</u>	<u>46,248,020</u>
Total liabilities	<u>44,617,463</u>	<u>13,831,221</u>	<u>58,448,684</u>
Net Position			
Net investment in capital assets	—	3,516	3,516
Unrestricted (deficit)	(35,502,059)	(3,516)	(35,505,575)
Total net position (deficit)	<u>\$ (35,502,059)</u>	<u>—</u>	<u>(35,502,059)</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Proprietary Funds
Statement of Revenues, Expenses, and Changes in Fund Net Position

Year ended June 30, 2013

	<u>Hotel Development Corporation</u>	<u>Slot Machines Operations</u>	<u>Total</u>
Operating revenues:			
Collection of funds from slot machines – net of \$146,434,354 distributions to participants of Slot Machines Operations	\$ —	163,280,338	163,280,338
Investment income	1,629,960	—	1,629,960
Interest income	5,070	—	5,070
Rent	1,886,884	—	1,886,884
Other	9,941	—	9,941
Total operating revenues	<u>3,531,855</u>	<u>163,280,338</u>	<u>166,812,193</u>
Operating expenses:			
Payroll and related-payroll benefits	—	10,192,604	10,192,604
Depreciation and amortization	—	38,497	38,497
Rent	9,906	87,861	97,767
Impairment losses on tourism projects	27,365,722	—	27,365,722
Other	1,027,469	3,716,774	4,744,243
Total operating expenses	<u>28,403,097</u>	<u>14,035,736</u>	<u>42,438,833</u>
Operating (loss) income	<u>(24,871,242)</u>	<u>149,244,602</u>	<u>124,373,360</u>
Nonoperating revenues (expenses):			
Contributions from Puerto Rico Sales Tax Financing Corporation and Commonwealth of Puerto Rico	1,048,235	—	1,048,235
Interest expense	(2,559,937)	—	(2,559,937)
Distributions to:			
Commonwealth of Puerto Rico	—	(22,610,557)	(22,610,557)
University of Puerto Rico	—	(67,831,672)	(67,831,672)
Total nonoperating revenues (expenses) – net	<u>(1,511,702)</u>	<u>(90,442,229)</u>	<u>(91,953,931)</u>
Excess (deficiency) of revenues over (under) expenses before transfers	<u>(26,382,944)</u>	<u>58,802,373</u>	<u>32,419,429</u>
Transfers:			
Transfers in	3,304,609	—	3,304,609
Transfers out	—	(58,802,373)	(58,802,373)
Total transfers – net	<u>3,304,609</u>	<u>(58,802,373)</u>	<u>(55,497,764)</u>
Change in net position	<u>(23,078,335)</u>	<u>—</u>	<u>(23,078,335)</u>
Net position (deficit) – beginning of year (as restated, see Note 2)	<u>(12,423,724)</u>	<u>—</u>	<u>(12,423,724)</u>
Net position (deficit) – end of year	<u>\$ (35,502,059)</u>	<u>—</u>	<u>(35,502,059)</u>

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Proprietary Funds
Statement of Cash Flows
Year ended June 30, 2013

	Hotel Development Corporation	Slot Machines Operations	Total
Cash flows from operating activities:			
Cash received from slot machines	\$ —	308,603,667	308,603,667
Cash received from investments in tourism projects	1,283,707	—	1,283,707
Cash received from rental activities	143,701	—	143,701
Cash paid to other participants of Slot Machines Operations	—	(157,799,895)	(157,799,895)
Cash paid for investments in tourism projects	(5,783,180)	—	(5,783,180)
Cash paid for payroll and related benefits	—	(9,544,542)	(9,544,542)
Cash paid for goods and services	(912,482)	—	(912,482)
Cash paid for other operating expenses	—	(3,655,876)	(3,655,876)
Net cash (used in) provided by operating activities	<u>(5,268,254)</u>	<u>137,603,354</u>	<u>132,335,100</u>
Cash flows from noncapital financing and related activities:			
Cash received from other funds	3,304,609	—	3,304,609
Distributions to:			
Commonwealth of Puerto Rico	—	(26,819,311)	(26,819,311)
University of Puerto Rico	—	(74,285,405)	(74,285,405)
Transfers to other funds	—	(36,498,638)	(36,498,638)
Net cash provided by (used in) noncapital financing activities	<u>3,304,609</u>	<u>(137,603,354)</u>	<u>(134,298,745)</u>
Net change in cash and cash equivalents	(1,963,645)	—	(1,963,645)
Cash and cash equivalents – beginning of year	<u>2,515,489</u>	<u>—</u>	<u>2,515,489</u>
Cash and cash equivalents – end of year	<u>\$ 551,844</u>	<u>—</u>	<u>551,844</u>

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Proprietary Funds
Statement of Cash Flows
Year ended June 30, 2013

	Hotel Development Corporation	Slot Machines Operations	Total
Reconciliation of operating income (loss) to net cash (used in) provided by operating activities:			
Operating income (loss)	\$ (24,871,242)	149,244,602	124,373,360
Adjustments to reconcile operating income (loss) to net cash (used in) provided by operating activities:			
Depreciation and amortization	—	38,497	38,497
Loss on disposition of capital assets	—	3	3
Impairment losses on tourism projects	27,365,722	—	27,365,722
Decrease in deferred debt issue costs	39,176	—	39,176
Changes in operating assets and liabilities:			
Increase in accounts receivable	(1,743,183)	(1,111,025)	(2,854,208)
Decrease in prepaid expenses	7,020	—	7,020
Increase in accrued return on investment	(176,104)	—	(176,104)
Increase in investment in tourism projects	(5,968,340)	—	(5,968,340)
Decrease in unremitted distributions to participants of Slot Machines Operations	—	(11,365,541)	(11,365,541)
Increase in accounts payable	78,697	148,756	227,453
Increase in accrued compensated absences and Christmas bonus	—	648,062	648,062
Net cash (used in) provided by operating activities	\$ (5,268,254)	137,603,354	132,335,100
Summary schedule of noncash financing activities:			
Contributions from Puerto Rico Sales Tax Financing Corporation and Commonwealth of Puerto Rico for payment of principal and interest on notes payable:			
Interest paid	\$ 1,048,235	—	1,048,235

See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
(A Component Unit of the Commonwealth of Puerto Rico)

Notes to Basic Financial Statements

June 30, 2013

(1) Reporting Entity

The Puerto Rico Tourism Company (the Company) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth) created by Law No. 10 of 1970 (Act No. 10) for the development of the tourism industry in Puerto Rico. The Company is exempt from taxation in Puerto Rico in accordance with Act No. 10.

As required by U.S. generally accepted accounting principles (GAAP), these basic financial statements present the financial position and results of operations of the Company and its component units. Component units are entities for which the Company is considered to be financially accountable. The Hotel Development Corporation (HDC), while legally separate from the Company, is reported as a blended component unit as part of the Company's proprietary funds. HDC is 100% owned by the Company. HDC is dedicated to promoting the development of the hotel and tourism industry, including the construction of tourism facilities, directly enhancing the Company's ability to develop the tourism industry in Puerto Rico. HDC's board of directors is the same as the Company's board of directors. Complete financial statements of HDC can be obtained directly by contacting the treasurer, HDC, Tanca Street No. 500, Ochoa Building, San Juan, Puerto Rico 00902.

(2) Restatement of Net Position and Fund Balance

During 2013, the Company identified the following errors related to the prior year financial statements:

- a) Capital assets in the governmental activities were overstated by \$750,000. An impairment loss occurred in prior year, but was not recognized.
- b) Interfund receivable in the general fund and interfund payable in the HDC fund of \$43,272,461 were overstated. The balances were eliminated because there was no intention of repayment.
- c) Interest payable in the HDC fund was overstated by \$334,181. Interest was accrued based on amounts subsequently paid and not based on amounts incurred at year end.
- d) Investment in tourism projects in the HDC fund were overstated by \$778,493. An investment resulting from the sale of incentive tax credits was deemed not realizable at June 30, 2012.
- e) Promotions Fund and Puerto Rico Tourism Industry Development Fund with fund balances of \$12,305,125 and \$7,623,142, respectively, were improperly reported as special revenue funds. These funds were combined with the general fund.

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The impact of these errors on the beginning net position reported in the government-wide financial statements was as follows:

	Governmental Activities	Business-Type Activities
Net position (deficit), July 1, 2012 as previously reported	\$ 40,967,123	(55,251,873)
Capital assets impairment (a)	(750,000)	—
Elimination of internal balances (b)	(43,272,461)	43,272,461
Decrease of interest payable (c)	—	334,181
Decrease of investment in tourism projects (d)	—	(778,493)
Net position, July 1, 2012 as restated	\$ (3,055,338)	(12,423,724)

The effect of these errors, had they been corrected in prior year financial statements, would have decreased the change in net position in the governmental activities by approximately \$6.9 million, from a decrease in net position of \$(12.1) million to \$(19.0) million and would have increased the change in net position in the business type activities by approximately \$5.7 million from \$(35.4) million to \$(29.7) million.

The impact of these errors on the beginning fund balance/net position reported in the fund financial statements was as follows:

	Governmental Funds			Proprietary Funds
	General Fund	Promotions Fund	Tourism Development Fund	Hotel Development Corporation
Fund balance/net position (deficit), July 1, 2012 as previously reported	\$ 4,692,840	12,305,125	7,623,142	(55,251,873)
Elimination of internal balances (b)	(43,272,461)	—	—	43,272,461
Decrease of interest payable (c)	—	—	—	334,181
Decrease of investment in tourism projects (d)	—	—	—	(778,493)
Elimination of special revenue funds (e)	19,928,267	(12,305,125)	(7,623,142)	—
Fund balance/net position, (deficit) July 1, 2012 as restated	\$ (18,651,354)	—	—	(12,423,724)

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The effect of the errors, had they been corrected in the prior year financial statements, would have decreased the net change in the General Fund balance by approximately \$4.9 million, from \$2.0 million to \$(2.9) million, and would have increased the change in net position in HDC by approximately \$5.7 million from \$(35.4) million to \$(29.7) million.

(3) Summary of Significant Accounting Policies

The accounting and reporting policies of the Company conform to U.S. GAAP prescribed by the Governmental Accounting Standards Board (GASB). The preparation of basic 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 basic financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(a) Government-Wide and Fund Financial Statements

Government-Wide Financial Statements – The statement of net position and the statement of activities report information on all activities of the Company. The effect of interfund balances has been removed from the government-wide statement of net position, except for the residual amounts due between governmental and business-type activities. Interfund charges for services among functions of the government-wide statement of activities have not been eliminated. The Company's activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services or interest earned on investment securities.

The statement of net position presents the Company's assets and liabilities, with the difference reported as net position. Net position is reported in three categories:

- Net investment in capital assets – consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any.
- Restricted – 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. When both restricted and unrestricted resources are available for use, generally it is the Company's policy to use restricted resources first, and the unrestricted resources when they are needed.
- Unrestricted – consist of net position that does not meet the definition of the two preceding categories. Unrestricted net position often is designated to indicate that management does not consider it to be available for general operations. Unrestricted net position often has constraints on resources, which are imposed by management, but can be removed or modified.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenue. Direct expenses are those that are clearly identifiable within a specific function or segment. Program revenues include (i) interest income on loans and

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investments in tourism projects, changes in the fair value of investment in tourism projects, and charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment and (ii) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not meeting the definition of program revenues are instead reported as general revenues.

Fund Financial Statements – Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The financial activities of the Company that are reported in the accompanying basic financial statements have been classified into governmental and proprietary funds.

Separate financial statements are provided for governmental and proprietary funds. Major individual governmental and proprietary funds are reported as separate columns in the fund financial statements. Non-major funds are aggregated into a single column.

(b) *Measurement Focus, Basis of Accounting, and Financial Statement Presentation*

Government-Wide Financial Statements – The government-wide 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 a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements have been met.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon they are both measurable and available. Revenues are considered to be available when they are collectible within the current period, or soon enough thereafter to pay the liabilities of the current period. For this purpose, the Company considers revenues to be available if they are collected within 90 days of the end of the fiscal year. Principal revenue sources considered susceptible to accrual include hotel room taxes and Commonwealth appropriations. Other revenues are considered to be measurable and available only when cash is received by the Company.

Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, principal and interest on general long-term debt, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Proceed of general long-term debt and acquisitions under capital leases are reported as other financing sources.

The general fund is the general operating fund of the Company and is used to account for all financial resources, except those required to be accounted for in another fund.

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The capital projects fund is a nonmajor governmental fund used to account for financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including acquisition or construction of capital facilities (other than those financed by proprietary funds).

Proprietary Fund Financial Statements – The basic financial statements of the proprietary funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above. The proprietary funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenue and expenses generally result from providing the services that correspond to the proprietary fund's principal ongoing operations. Operating revenues are generated from lending, investing, and other related activities. Operating expenses include tourism projects related expenses, provisions for loan losses and doubtful accounts receivable, and all general and administrative expenses, among others. Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses.

The following business-type activities of the Company are reported as major proprietary funds:

- **Hotel Development Corporation (HDC) Fund** – HDC is a blended component unit engaged to promote the development of the hotel and tourism industry, including the construction of tourism properties, in Puerto Rico.
- **Slot Machines Operations Fund** – The slot machines operations fund accounts for the activities related to the collection of funds from slot machines located in Puerto Rico and for its final distribution to recipients established by legislation.

Cash and Cash Equivalents – Cash and cash equivalents include investments with maturities of 90 days or less from the date of acquisition.

Investments – The Company is authorized to invest predominantly in the following:

- U.S. government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations, and instrumentalities
- Certificates and time deposits
- Mortgage and asset-backed securities
- Corporate notes
- External investments pools

Investments are reported at fair value, using quoted market prices whenever available. For securities without quoted market price, fair values represent quoted market prices for comparable instruments.

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Realized gains and losses from the sale of investments and unrealized changes in fair value are recorded as investment income. Money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less, and nonparticipating investment contracts are reported at cost. Investment positions in 2a-7 like external investment pools, are reported at the pool's share price.

Hotel Room Taxes Receivable – Hotel room taxes represent amounts collected by the hotels and due to the Company on hotel room occupancy. Such receivables are recorded net of an estimate for uncollectible amounts.

Loans Receivable and Allowance for Losses on Loans Receivable – Loans receivable are presented at the outstanding unpaid principal balance reduced by an allowance for loan losses. Loans receivable are measured for impairment when it is probable that all amounts, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement. Interest accrual ceases when collectibility is uncertain, generally once a loan receivable is 180 days past due. Once a loan receivable is placed in nonaccrual status, all accrued but uncollected interest is reversed against current interest income. Interest income on nonaccrual loans receivable is thereafter recognized as income only to the extent actually collected. Nonaccrual loans receivable are returned to an accrual status when management has adequate evidence to believe that the loans receivable will be performing as contracted.

The allowance for losses on loans receivable is established through provisions recorded as an operating expense. This allowance is based on the evaluation of the risk characteristics of the loan receivable or loans receivable portfolio, including such factors as the nature of the individual credit outstanding, past loss experience, known and inherent risks in the portfolios, and general economic conditions. Charge-offs are recorded against the allowance when management believes that the collectibility of the principal is unlikely. Recoveries of amounts previously charged off are credited to the allowance. Because of uncertainties inherent in the estimation process, management's estimate of credit losses in the outstanding notes receivable portfolio 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 receivable to be impaired when it is probable that the Company 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 receivable are accounted for predominantly in the same manner as nonaccrual loans receivable.

Loans receivable considered to be impaired are generally reduced to the present value of expected future cash flows, discounted at the note's effective interest rate or, at the note's observable market price or the fair value of the collateral if the loan receivable is collateral dependent, by establishing a valuation allowance.

Investment in Tourism Projects – Investments in tourism projects represent redeemable preferred interests in companies and partnerships engaged in the development of hotels and tourism-related

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facilities in Puerto Rico. These investments are initially reported at cost and subsequently measured in accordance with the corresponding stockholders' or partnership agreement.

Investments in tourism projects are periodically evaluated for impairment. Management periodically evaluates the financial position and the results of operations of investees, and other industry and economic factors to determine if there are indicators that an other-than-temporary impairment in the value of the investment has occurred. Other-than-temporary impairment charges are recorded as part of the investment earnings (losses) in the accompanying financial statements.

During 2013 the Company made a decision to provide for an impairment loss allowance of approximately \$27.9 million on all its investments in tourism projects based on: (i) relative high risk associated with these start-up tourism real estate projects, (ii) the Company's historical negative investment return experience on similar tourism projects where only limited amount of the original capital investment was returned and (iii) weakness of the Puerto Rico economy.

Capital Assets – Capital assets are reported in the applicable governmental or business-type activities columns in the government-wide financial statements and in the proprietary fund statement of net position. Capital assets are defined by the Company as assets with a cost of \$500 or more at the date of acquisition and an expected useful life of three or more years. Purchased and constructed capital assets are valued at historical cost or estimated historical cost. Donated fixed assets are recorded at their fair value at the date of donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are expensed.

Capital asset additions in governmental activities are recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the proprietary funds financial statements.

Capital asset are depreciated using the straight-line method over the assets' estimated useful lives. Land, construction in progress, and works of art are not depreciated. Estimated useful lives are as follows:

Description	Years
Infrastructure	50
Buildings and buildings improvements	50
Leasehold improvements	Lesser of 50 years or lease term
Furniture and equipment	3–7
Vehicles	Lesser of 5 years or lease term

Interfund Activities

The Company has the following types of interfund transactions:

Loans – Represents amounts provided with a requirement for repayment. Interfund loans are reported as interfund receivables (i.e. due from other funds) in lender funds and interfund

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payables (i.e. due to other funds) in borrower funds. Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset equally by nonspendable fund balance which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

Services provided and used – Represents sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used are reported as revenues in seller funds and expenditures or expenses in purchaser funds. Unpaid amounts are reported as interfund receivables and payables in the fund balance sheets or fund statements of net position.

Reimbursements – Represents repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements are reported as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers – Represents flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the fund making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers are reported after nonoperating revenues and expenses.

Fund Balance – Governmental Funds

The Company reports fund balance amounts that are considered nonspendable, such as fund balances associated with prepaid amounts. Other fund balances have been reported as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent, as described below:

- *Nonspendable* – Represents resources that cannot be spent readily with cash or are legally or contractually required not to be spent. For the Company, the amount presented herein is composed of prepaid amounts and a note receivable.
- *Restricted* – Represents resources that can be spent only for the specific purposes stipulated by constitutional provisions, external resource providers (externally imposed by the commonwealth, creditors, or grantors), or through enabling legislation (that is, legislation that creates a new revenue source and restricts its use). Effectively, restrictions may be changed or lifted only with the consent of resource providers.
- *Committed* – Represents resources used for specific purposes, imposed by formal action of the Company's highest level of decision-making authority (the board of directors) and can only be charged by a similar action, no later than the end of a fiscal year.
- *Assigned* – Represents resources intended to be used by the Company for specific purposes, but do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Company's Executive Director). There was no assigned fund balance at June 30, 2013.

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- *Unassigned* – Represents the residual classification for the Company’s general fund and includes all spendable amounts not contained in the other classifications.

In situations where expenditures are made for a purpose for which amounts are available in multiple fund balance classifications, the Company uses restricted resources first, and then unrestricted resources. Within unrestricted resources, the Company generally spends committed resources first, followed by assigned resources, and then unassigned resources.

Long-Term Debt and Deferred Issuance Costs – Long-term debt is presented net of the applicable debt premium, discount, and deferred losses arising from debt refunding. Deferred issuance costs are reported as a separate line item in the government-wide and proprietary fund statements of net position. Debt premiums, discounts and deferred issuance costs are deferred and amortized over the life of the debt using a method that approximates the effective interest method. Refunding losses are deferred and amortized over the life of the debt using the straight line method. Governmental fund types recognize bond premiums and discounts during the current period. The face amount of debt issued, as well as any related premium is reported as other financing source while discounts on debt issuances are reported as other financing use. Issuance costs are recorded as expenditures when paid in the governmental funds.

Refundings – Refundings involve the issuance of new debt whose proceeds are used to repay immediately (current refunding) or at a future time (advance refunding) previously issued debt. In the government wide and proprietary fund financial statements, the difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported as addition or deduction from the new debt.

Compensated Absences – Employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated up to a maximum of 60 and 90 days, respectively. In the event of employee resignation, an employee is reimbursed for accumulated vacation days up to the maximum allowed. For sick leave, in the event of employee resignation, the employee is paid up to the maximum allowed if the employee has worked with the Company or any other instrumentality of the Commonwealth for 10 years or more, and up to 40% of the accumulated amount if the employee has worked between 1 to 10 years. The governmental fund financial statements record expenditures when employees are paid for leave, except for certain applicable sick leave portions that have matured and are payable in July, which are consequently accrued at June 30.

The government-wide financial statements present the cost of accrued compensated absences as part of other accrued long-term liabilities. The proprietary funds statement of net position separately presents the liability for accrued compensated absences. The liability for compensated absences reported in the government-wide and proprietary fund financial statements has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees’ current salary level and includes salary related costs (e.g., social security and medicare tax).

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Early Retirement – The Company recorded in the government-wide financial statements an expense for termination benefits when the offer was accepted by the employee and the benefit amount was determined.

Risk Management – The Company purchases commercial insurance to cover for casualty, theft, tort claims, and other losses through the Treasury Department negotiated under a blanket agreement and then charged to the Company. The current insurance policies have not been canceled or terminated. There have been no settlements of insurance claims that exceed coverage under such policies in any of the past three years.

Adoption of Recent accounting Pronouncements - During the fiscal year ended June 30, 2013, the Company adopted the following new accounting standards issued by the GASB:

- GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. The implementation of GASB Statement No. 60 did not have an impact on the financial statements.
- GASB Statement No. 61, *The Financial Reporting Entity: Omnibus – an amendment of GASB Statements No. 14 and No. 34*. The implementation of GASB Statement No. 61 did not have an impact on the financial statements.
- GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The implementation of GASB Statement No. 62 did not require modification to the financial statements.
- GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The implementation of GASB Statement No. 63 did not have a significant impact on the Company's financial statements.

Future Accounting Pronouncements – The GASB has issued the following accounting pronouncements that may have a future impact on the accounting and financial reporting of the Company. However, the actual effect has not yet been determined:

- GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which is effective for periods beginning after December 15, 2012.
- GASB Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62*, which is effective for periods beginning after December 15, 2012.
- GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*, which is effective for periods beginning after June 15, 2014.
- GASB Statement No. 69, *Government Combinations and Disposal of Government Operations*, which is effective for periods beginning after December 15, 2013.
- GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*, which is effective for periods beginning after June 15, 2013.

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(4) Stewardship and Accountability

As of June 30, 2013, the business-type activities and the HDC fund present a deficit of approximately \$35.5 million because for several years this component unit has not been able to recover the investments made in tourism projects and has recognized permanent impairment losses in the fair value of these investments.

The notes payable reported by the HDC Fund in the accompanying statement of net position are being repaid with annual Commonwealth appropriations (see Note 11). The deficit of the HDC Fund is expected to decrease as the Commonwealth appropriations amortize the principal balance on these notes.

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline and high levels of debt and pension obligations. In recent months, the widening of credit spreads for the Commonwealth's public sector debt and the recent downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to non-investment grade by Moody's, S&P and Fitch has put further strain on the Commonwealth's liquidity and may affect its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

If the Commonwealth's financial condition does not improve as a result of these or other factors, it may lack sufficient resources to repay its obligations or those of its component units, including the notes payable reported by the HDC. In the event the Commonwealth ceases to appropriate sufficient resources, and other external options are not available for the payment of HDC notes payable, the Company has the ability to use its own internal resources for the debt service of such notes.

(5) Deposits and Investments

The Company is authorized to deposit funds in the Government Development Bank for Puerto Rico (GDB), a component unit of the Commonwealth, and/or in the custody of financial institutions approved by the Commonwealth. Commonwealth's regulations require domestic commercial banks to maintain collateral securities pledged for the security of public deposits at an amount not less than 100% of the amounts in excess of federal insurance coverage. GDB is exempt from the collateral requirements established by the Commonwealth.

Deposits either insured or collateralized are not considered to be subject to custodial risk, which is the risk that in the event of a bank's failure, the Company's deposits may not be returned to it. As of June 30, 2013, the Company had approximately \$4,397,213 of deposits subject to custodial risk.

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As of June 30, 2013, the Company's cash (excluding cash on hand of \$8,968 and cash equivalents of \$4,826,790) consist of the following:

<u>Financial Institution</u>	<u>Carrying amount</u>	<u>Depository bank balance</u>	<u>Uninsured or uncollateralized</u>
GDB	\$ 4,397,213	4,397,213	4,397,213
Nongovernment banks	5,220,323	8,933,256	—
	<u>\$ 9,617,536</u>	<u>13,330,469</u>	<u>4,397,213</u>

The Company's cash equivalents as of June 30, 2013, are as follows:

<u>Investment type</u>	<u>Fair value</u>
Time deposit with GDB	\$ 4,191,087
U.S. Treasury notes	239,998
Time deposit with other private financial institutions	148,288
Money market fund with private financial institutions	66,231
Puerto Rico Government Investment Trust Fund	181,186
Total cash equivalents	<u>\$ 4,826,790</u>

The following table summarizes the type and maturities of investments held by the Company at June 30, 2013. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	<u>Within one year</u>	<u>After one to five years</u>	<u>After five years</u>	<u>Total</u>
U.S. Treasury notes	\$ —	9,699,330	—	9,699,330
U.S.-sponsored agencies:				
Federal Farm Credit Bureau (FFCB)	1,005,990	—	—	1,005,990
Federal Home Loan Mortgage Corporation (FHLMC)	—	7,174,984	935,839	8,110,823
Federal National Mortgage Association (FNMA)	2,004,260	1,702,703	—	3,706,963
Corporate bonds — Caterpillar, Inc.	2,520,235	—	—	2,520,235
Municipal bonds:				
GDB	2,002,960	3,764,524	—	5,767,484
Puerto Rico Aqueduct and Sewer Authority (PRASA)	550,226	1,973,860	—	2,524,086
Puerto Rico Highway and Transportation Authority (PRTHA)	1,458,974	2,596,370	—	4,055,344
Other	555,000	—	—	555,000
Total investments	<u>\$ 10,097,645</u>	<u>26,911,771</u>	<u>935,839</u>	<u>37,945,255</u>

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Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the Company manages its exposure to declines in fair values by diversifying the weighted average maturity date of its investment portfolio. The Company is expected to achieve capital preservation and income generation by investing in a diversified portfolio of marketable, investment-grade core fixed-income securities.

Credit Risk – Credit risk is the risk that an issue or other counterparty to an investment will not fulfill its obligations. The Company’s general investment policy is to apply the prudent-person rule, which establishes that investments are made, as a prudent person would be expected to act, with the discretion and intelligence, to seek reasonable income, preserve capital, and, in general, avoid speculative investments. The Company’s investment policy limits long-term investments in corporate debt to the top three ratings issued by nationally recognized statistical rating organizations, and short-term investments in corporate debt to the top two ratings issued by nationally recognized statistical rating organizations.

All of the Company’s investments in U.S. Treasury notes carry the explicit guarantee of the U.S. government. The credit quality ratings for investments in debt securities, excluding U.S. Treasury notes, as of June 30, 2013, are as follows:

Securities type	Credit risk rating						Total
	AAA	AA+ to AA-	A	BBB+ to BBB-	BB+	Not rated	
U.S. sponsored agencies:							
FFCB	\$ —	1,005,990	—	—	—	—	1,005,990
FHLMC	7,174,984	935,839	—	—	—	—	8,110,823
FNMA	3,706,963	—	—	—	—	—	3,706,963
Corporate bonds:							
Caterpillar, Inc.	—	—	2,520,235	—	—	—	2,520,235
Municipal bonds:							
GDB	—	3,764,524	—	2,002,960	—	—	5,767,484
PRASA	—	—	—	550,226	1,973,860	—	2,524,086
PRHTA	2,369,531	682,603	—	—	—	1,003,210	4,055,344
Other	—	—	—	—	—	555,000	555,000
Total	\$ 13,251,478	6,388,956	2,520,235	2,553,186	1,973,860	1,558,210	28,245,925

Concentration of Credit Risk – The Company places no limit on the amount it may invest in any one issuer. As of June 30, 2013, 21% of the Company’s investments are in fixed-income notes of the Federal Home Loan Mortgage Corporation, 10% are in notes of the Federal Home Loan Mortgage Association, 7% are in corporate bonds, 15% are in GDB bonds, 7% are in PRASA bonds, 11% are in PRHTA bonds, and 1% are in other municipal bonds. Approximately 32% (\$12.3 million) are invested in bonds of the Commonwealth and its instrumentalities.

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(6) Notes and Loans Receivable

Governmental activities notes receivable consist of a promissory note in the original amount of \$1.5 million, due in ten annual equal installments accruing interest at 6.25%, and is due as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year Ending June 30:			
2014	\$ 150,000	84,375	234,375
2015	150,000	75,000	225,000
2016	150,000	65,625	215,625
2017	150,000	56,250	206,250
2018	150,000	46,875	196,875
2019 – 2022	600,000	37,500	637,500
	<u>\$ 1,350,000</u>	<u>365,625</u>	<u>1,715,625</u>

Business-type loans receivable as of June 30, 2013 is as follows:

<u>Description</u>	<u>Amount</u>
Loan receivable – current:	
Unsecured noninterest-bearing loan, due from Rio Mar-G.P. L.P. collectible from available distributions, if any, from the partners of Rio Mar Associates' S.E., at rate denominated as 50% of Rio Mar Associates' preferred return, as defined, not to exceed \$319 thousand annually.	\$ 3,092,483
Nonrevolving credit facility of \$6 million due from Juaza, Inc. Interest is collectible monthly on the last day of each month at an interest rate of 250 basis points over prime rate. The credit facility was due on June 30, 2010, and is collateralized by a parcel of land located in Luquillo, Puerto Rico, owned by Juaza, Inc., and the Trust of Public Land, all personal property of Juaza, Inc., and the personal guarantee of Juaza, Inc.'s stockholders.	7,546,186
Interim nonrevolving loan of \$7.5 million to cover certain predevelopment expenses in connection with the construction of a hotel composed of 299 guest rooms and related parking facilities and amenities on a portion of a parcel of land known as Parcel H-2 at the Coco Beach Resort in Rio Grande, Puerto Rico, which hotel is expected to be denominated the JW Marriot Hotel and Stellaris Casino at Coco Beach. The interim loan will bear interest at a fixed annual interest rate of 8%. Interest shall be payable quarterly in arrears on the first day of January, April, and October of each year. Unpaid interest shall be calculated on a quarterly compounded basis.	7,776,514
Other	162,651
Total	<u>18,577,834</u>
Less allowance for losses on loans receivable	<u>(18,562,523)</u>
Loans receivable – current – net	<u>\$ 15,311</u>

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Description	Amount
Loan receivable – noncurrent:	
\$25 million subordinated loan secured by a demand second mortgage over the La Concha and Condado Vanderbilt Hotels and a master security agreement over the developers assets, contracts, and bank depository account. The aggregate unpaid principal amount of the disbursements interest and other amounts shall be payable in full no later than October 27, 2019. Interest for the period commencing October 27, 2009, and ending on October 26, 2014, is the prime rate, plus 3% per annum, for the period commencing on October 27, 2014, and ending on October 26, 2017, 11% per annum, and for the period commencing on October 27, 2017, and ending on the maturity date, 12.50% per annum.	\$ 30,183,269
Nonrevolving loan of \$500 thousand due from WC Owner, LLC at a fixed rate of 8% per annum compounded on an annual basis payable in arrears on the first day of January, April, July, and October of each year during the term hereto and on the due date. This loan is due on December 31, 2016.	340,483
Loans receivable	30,523,752
Less allowance for losses on loans receivable	(30,523,752)
Loans receivable – noncurrent – net	\$ <u><u>—</u></u>

At June 30, 2013, nonperforming loans amounted to approximately \$49.1 million. Interest income that would have been recorded during the year ended June 30, 2013 if these loans had performed in accordance with their original terms would have been approximately \$3.0 million.

At June 30, 2013, the Company has recorded loans receivable of \$49,086,275 and has provided an allowance for loan losses for the same amount. In addition, the Company did not recognize interest income on such loans during the year ended June 30, 2013. The summary of the activity in the allowance for loan losses for the year ended June 30, 2013 is as follows:

Balance – beginning of year	\$ 43,208,492
Provision for loan losses	<u>5,877,783</u>
Balance – end of year	<u><u>\$ 49,086,275</u></u>

In 2009, HDC sold the surface rights on certain properties for \$9.7 million. HDC provided 100% seller financing through the issuance of two mortgage notes, which bore no interest. These notes were subordinated to a construction loan in the amount of \$165 million with the Puerto Rico Tourism Development Fund, an instrumentality of the Commonwealth and a component unit of the GDB, and to an additional \$25 million development loan (the Loans). During 2014, TDF and HDC entered in a series of transactions with a third party developer (the Developer) that resulted in the settlement, discharge, and release of the Loans pursuant to a settlement agreement dated March 10, 2014 (the Settlement Agreement) in exchange for the completion of the construction of the Condado Vanderbilt Hotel and the Vanderbilt Hotel Towers (the Vanderbilt Hotels). Also on March 10, 2014, the Company issued an administrative

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order authorizing the imposition of a temporary 2% charge on the guest stays at the Vanderbilt Hotels as a sole source of repayment of the outstanding \$9.7 million surface rights debt.

These transactions were accounted for at inception under the cost recovery method as provided for in GASB 62. Therefore, no profit is recognized until cash payments by the buyer, including principal and interest on debt due to the seller and on existing debt assumed by the buyer, exceed the seller's cost of the property sold. The receivable less profits not recognized, if any, does not exceed what the depreciated property value would have been if the property had not been sold.

(7) Investment in Tourism Projects

As of June 30, 2013, investments in tourism projects consist of the following:

Tourism project	Carrying amount
DBR Dorado Owner LLC (DBR)	\$ 15,000,000
Vieques Hotel Partners (VHP)	8,336,634
Bahía Beach CH Development, LLC (“St. Regist Hotel at Bahía Beach Resort and Golf Club” or “Bahia Beach”)	13,856,667
Condado Palm, LLC (“Condado Palm”)	1,815,456
CCHPR Holding, LLC (“Sheraton Puerto Rico Convention Center Headquarters Hotel” or “CCHPR”)	18,101,417
Old San Juan Associates L.P., S.E. (“Old San Juan”)	253,576
WC Manager LLC (WC)	1,015,861
Flagship Resorts Properties, S.E. (“Flagship”)	4,145,283
District Hotel Company, LLC (“DHC”)	4,102,154
Total	66,627,048
Less allowance for losses in tourism projects	(62,727,085)
Investment in tourism projects - net	\$ 3,899,963

During 2013 impairment adjustments in the amounts of \$15,000,000, \$8,336,634, \$2,120,250, \$484,522 and \$1,424,316 were recorded on the investments in DBR, VHP, Bahia Beach, Flagship and DHC, respectively.

(a) DBR

In July 2009, HDC entered into a loan agreement with DBR Dorado Owner, LLC (DBR) for a nonrevolving term loan with a principal amount not to exceed \$7.5 million. The loan was used to cover certain predevelopment costs related to Phase I of the Luxury Hotel Project. The loan bore interest at 8% per annum and had a maturity date of July 29, 2010. In conjunction with the closing of the note purchase and credit agreement on July 14, 2010, the outstanding balance on the loan of \$7.5 million was converted into a Class A preferred equity investment in DBR and HDC contributed an additional \$7.5 million for a total preferred equity investment in DBR of \$15 million.

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HDC's participation in the allocation of net profits will be based on the contractually determined current and accumulated return of investment, provided that no losses will be allocated to HDC. As a Class A preferred investor, HDC will be entitled based on its outstanding net invested capital from time to time payable in cash, except as indicated:

- From July 1, 2013 to June 30 2014, 9% per annum
- From July 1, 2014 to June 30, 2015, 10% per annum
- From July 1, 2015 to June 30, 2016, 11% per annum
- From July 1, 2016 to June 30, 2018, 13% per annum
- From July 1, 2018 to June 30, 2020, 15% per annum
- From July 1, 2020 until the Class A redemption date, 18% per annum

DBR Dorado Member LLC, as managing member, shall decide when to redeem HDC as the Class A member provided, however, that on the 10th anniversary of the closing date, if the Class A member has not been paid, (i) the Class A member shall receive all distributions of available cash flows as a priority before any other distribution is made until such member has been paid in full and (ii) DBR shall not pay any fees under the development management agreement, the asset management agreement, or under any other service agreement with affiliates of DBR and/or of the parent related to the luxury hotel until the Class A member is paid in full.

At any time after the 10th anniversary of the closing date, the Class A member shall have the right to demand payment in full of the Class A redemption price (the Put Option), which it shall do by giving notice to DBR of the date when such Put Option must be satisfied by DBR, which shall be no sooner than 30 days after the effective date of the notice. This investment has no carrying value since it was considered other-than-temporarily impaired.

As of June 30, 2013 total dividends in arrears on this preferred interest aggregated approximately \$3.9 million.

(b) VHP

On June 3, 2011, HDC entered in an agreement with Vieques Hotel Partners to make capital contributions of \$8.5 million to cover the W Retreat & Spa (the W) projected capital needs. This investment served to stabilize the W's operations as the plan was developed and implemented. HDC will be entitled to an investment fee equal to 1% of the approved investment limit, equivalent to \$85 thousand.

HDC shall submit to the managing partner at least 10 days prior to each calendar year quarter a statement on the term under which its costs of funds will be calculated during such calendar year quarter. However, HDC's investment policy states that the investment must have an annual return equivalent to the following at the prime rate or whichever is higher: from the closing date to June 2, 2015, 4%; from June 3, 2015 to June 2, 2016, 6%; from June 3, 2016 to June 2, 2017, 7%; from

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June 3, 2017 to June 2, 2018, 8%; from June 3, 2018 to June 2, 2019, 9%; and from June 3, 2019, and thereafter, 10% until full redemption of capital contributed.

Unpaid minimum return will be added to HDC's net invested capital and the HDC minimum return shall continue to be compounded annually under this new basis. The managing partner shall decide when to redeem HDC at the HDC redemption price, provided however, that on the 10th anniversary of the effective date, HDC has not been paid the redemption price, the partnership shall distribute all available cash flow to HDC and shall not pay any fees under the deed related to the hotel with an affiliate of the partnership, until HDC has been paid the HDC redemption price in full. No losses will be allocated to HDC.

(c) ***Bahía Beach***

Bahía Beach is a Puerto Rico limited liability company that developed, owns, and operates the St. Regis Hotel at Bahía Beach Resort & Golf Club in the Municipality of Rio Grande, Puerto Rico. On June 6, 2008, HDC approved an investment of \$12 million, not to exceed 10% of the total project cost. The agreement with Bahía Beach establishes that HDC is a Class A preferred investor and as such will have no obligation to make any other capital contribution other than its initial capital contribution. HDC shall not have any obligation to provide any guarantee, undertaking, or credit enhancement with respect to any project debt. HDC's participation in the allocation of net profits or losses will be in proportion to the relative amount allocable to each investor, except that all losses incurred prior to opening date will be allocated only to the developer investor and not HDC. The investment yield shall equal 5% during the construction phase and shall increase to 9.5% during the operational phase. This investment has no carrying value because of allocated operating losses.

As of June 30, 2013, total dividends in arrears on this preferred interest aggregated approximately \$5 million.

(d) ***Condado Palm***

In May 2012, HDC entered in to a limited liability company agreement (the LLC Agreement) with Condado Palm, LLC to develop the Condado Palm project, a construction and development of a project to be located on the premises of the former Diamond Palace Hotel in the Condado District of San Juan, Puerto Rico. International Hospitality Operations, LLC, is managing this project. HDC's board of directors authorized an investment in Condado Palm's Class A membership that consisted of a cash contribution of approximately \$1 million on the date thereof, the execution of a legally binding commitment to contribute up to \$950 thousand in cash upon request by the managing member, and the proceeds of the sale of tax credits allocated to HDC. The contributions to be provided under the Class A legally binding commitment shall only be used to fund the Condado Palm Project's Debt Services Reserve Fund as required under the financing facilities. The proceeds from the sale of tax credits, which amounted \$778 thousand, were reinvested in Condado Palm's Class A membership.

HDC is entitled to an investment fee equal to 1% of its initial capital contribution, which fee shall be payable on the closing date from amounts received from Condado Palm's owner. In addition, HDC

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shall be entitled to a stand-by fee equal to 2.5% per annum of its undisbursed portion of the Class A legally binding commitment.

As a Class A member, HDC will be entitled to the following return payable pursuant to i) equal amount to the Class A redemption price and ii) any compensatory contribution at a rate of 16% per annum compounded quarterly and to repay such compensatory contribution, based on its outstanding net invested capital from time to time, in accordance to the following schedule, payable in cash, except as indicated below:

- From the closing date to December 31, 2014, 9.5% per annum
- From January 1, 2015 to December 31, 2015, 10% per annum
- From January 1, 2016 to December 31, 2016, 10.5% per annum
- From January 1, 2017 to December 31, 2017, 11.5% per annum
- From January 1, 2018 to December 31, 2018, 12.5% per annum
- From January 1, 2019 to December 31, 2019, 13.5% per annum
- From January 1, 2020 to December 31, 2020, 14.5% per annum
- From July 1, 2021 until the Class A redemption date, the greater of 15.5% per annum or HDC's cost of funds

The return accrued is only for the original investment. The investment originated from the reinvestment of the proceeds from the sales of tax credits does not generate interest. As of June 30, 2013 total dividends in arrears on this preferred interest aggregated approximately \$119,000. No losses should be allocated to HDC on this investment.

(e) CCHPR

The investment consists of a 41% limited liability partnership interest in a Puerto Rico limited liability company, known as CCHPR, which was engaged in the construction of the Sheraton Puerto Rico Convention Center Hotel. On July 12, 2006, pursuant to the agreement between CCHPR and HDC, HDC paid an initial capital contribution of \$14.5 million to acquire all outstanding Class A preferred shares. CCHPR Hospitality LLC agreed to pay HDC a one-time fee equal to 1% of the capital contributed, payable on the Class A redemption date, and an annual fee equal to 0.36% of net investment capital outstanding commencing a year after closing date until the Class A redemption date. These fees are accumulated and payable upon full redemption of the capital contributed by HDC.

HDC's participation in the allocation of net profits or losses will be in proportion to the relative amount allocable to each investor, except for allocation of losses prior to the opening date of the hotel. In the event that allocation of losses cause HDC to have an adjusted capital account deficit, then the amount of such loss shall be allocated instead to another member. As a Class A, preferred investor, the return on HDC's investment is as follows: 5% annually from August 28, 2006 to August 27, 2009; 10% annually from August 28, 2009 to August 27, 2010; 11% annually from

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August 28, 2010 to August 27, 2011; 12% annually from August 28, 2011 to August 27, 2012; 13% annually from August 28, 2012 to August 27, 2013; and 14% annually from August 28, 2013 to Class A redemption date on which such preferred interest is redeemed in full. This investment has no carrying value since it was considered other-than-temporarily impaired in previous years.

As of June 30, 2013, total dividends in arrears on these preferred interests aggregated approximately \$11 million.

(f) Old San Juan

The investment consists of a 28.47% limited partnership interest. Pursuant to the partnership agreement between Old San Juan Holdings, L.P. and HDC, HDC made an initial capital contribution of \$3.3 million to the partnership. The partnership agreement established that if at any time additional funds, in excess of the amounts invested, are required by Old San Juan to pay for shortfalls, the general partner may request additional contributions in an amount sufficient to cover such shortfalls. HDC participates in the allocation of the net profit and net losses in proportion to the relative amounts allocable to each investor in the investment account. This investment has no carrying value since it was considered other-than-temporarily impaired in a prior year.

(g) WC

On September 18, 2009, HDC entered into a limited liability company agreement for the project known as San Juan Water Club. HDC is the Class A preferred interest owner and WC is the Class B interest owner. HDC made a capital contribution for its Class A preferred interest of \$1 million and WC made a capital contribution for its Class B interest of \$1.2 million. Any one of the members may determine in its sole discretion from time to time whether the Agreement needs capital over and above the original capital contributed and to be contributed.

Except to the extent of distributions made pursuant to the Agreement, no member shall be entitled to the withdrawal or return of its capital contributions, nor may any member withdraw from this agreement or otherwise have any right to demand or receive the return of its capital contribution. HDC will be entitled to an investment fee equal to 1% of its initial capital contribution, which fee shall be payable on the closing date from amounts received from WC owner. Subject to the terms of any project debt, the manager shall cause WC to make cash distributions of operational cash flow to the member quarterly following the closing date (except during 2009 when one distribution would be made at the end of the year and 2010 when they would be made twice a year).

The return of HDC as Class A preferred interest owner is equal to a noncompounding cumulative return, computed based on its outstanding net invested capital from time to time, subject to the date on which the contribution is disbursed pursuant to the funding commitment, in accordance with the following schedule, payable in cash within 15 days after the end of each quarter, except as indicated:

- From the closing date to June 30, 2011, 10% per annum
- From July 1, 2011 to June 30, 2012, 11% per annum

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- From July 1, 2012 to June 30, 2013, 12% per annum (payment of 3% of the 12% may be deferred until the Class A redemption date)
- From July 1, 2013 to June 30, 2014, 13% per annum (payment of 4% of the 13% may be deferred until the Class A redemption date)
- From July 1, 2014 until the Class A redemption date, 13% per annum (payment of 4% of the 13% may be deferred until the Class A redemption date)
- No losses should be allocated to HDC.

This investment has no carrying value since it was considered other-than temporarily impaired in prior years.

(h) *Flagship*

During the year ended June 30, 2004, HDC invested \$2.2 million in Flagship in exchange for a partnership interest in the Holiday Inn Project, also known as the Carib Inn Hotel. HDC's investment included the proceeds from the sale of investment tax credits amounting to \$666 thousand. This investment consists of a preferred partnership interest that does not provide a participating interest in the partnership as a general partner, and therefore, HDC does not participate in the earnings or losses of the partnership.

Flagship may redeem the HDC investment on or before the sixth anniversary of the investment date at a redemption price equal to the product of the initial capital contribution multiplied by the rate applicable to the year when the redemption occurs as stated in the partnership agreement, plus accrued unpaid interest. Accrued interest is paid at an interest rate determined yearly ranging from 6% to the highest of 19% or 2% over prime rate. If HDC's partnership interest is not redeemed upon the expiration of the sixth anniversary of the investment date, the redemption price shall be due and payable to HDC immediately in full.

During September 2009, HDC approved an extension to the preferred partner redemption return date from September 30, 2009 to July 31, 2011. On September 8, 2010, deed number four was signed, Deed of First Amendment to Amended and Restated Deed of Special Partnership Agreement. This amendment also approves a reduction in the interest rate applicable to the year when the preferred partner redemptions occur. Accrued interest is paid at an interest rate determined yearly ranging from 6% to the highest of 15% until the fifth anniversary, and 8% during the year after the six anniversary of the closing date or any anniversary thereafter, or 2% over prime rate.

On December 20, 2011, HDC approved an additional investment of \$1 million in Flagship's preferred partnership interest. The investment served the following purposes: (a) complete the refurbishing and rehabilitation of the hotel; (b) retire certain operating debts of vendors and suppliers that have accumulated over the last year; and (c) for any other uses acceptable to HDC. The preferred partnership interest shall be redeemed at the earlier of (1) July 31, 2014 or (2) immediately after Scotiabank de Puerto Rico and Puerto Rico Tourism Development Fund authorize the partnership to make distributions of cash flow or net proceeds.

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Notwithstanding the foregoing, at a minimum, the partnership must pay to HDC, on a monthly basis, an amount equivalent to HDC'S cost of funds, with 100% of the amounts received by HDC as a return on the investment.

This impairment has no carrying value since it was considered other-than-temporarily impaired.

(i) ***DHC***

On October 22, 2012, HDC entered into a limited liability company agreement for the project District Hotel Company, LLC (DHC). HDC is the Class A preferred interest owner and Island Hospitality Partners, LLC (IHP) is the Class B interest owner. HDC made a capital contribution for its Class A preferred interest of approximately \$2.9 million and IHP made a capital contribution for its Class B interest of approximately \$3.2 million, and entered into a legally binding commitment to contribute approximately \$5.7 million. HDC will not have any obligation to make any other capital contribution of any kind.

Except to the extent of distributions made pursuant to the Agreement, no member shall be entitled to the withdrawal or return of its capital contributions, nor may any member withdraw from this agreement or otherwise have any right to demand or receive the return of its capital contribution. HDC will be entitled to an investment fee equal to 1% of its initial capital contribution, which fee shall be payable on the closing date. Subject to the terms of any project debt, HDC will be entitled to an annual amount equal to 0.5% of any unredeemed portion of HDC's membership interest due on the anniversary of the closing date.

The return of HDC as Class A preferred interest owner will accrue on an annually compounding basis from its funding date until paid, in accordance with the following schedule, payable in cash except as indicated:

- From the closing date to the last day of the 24th month therefrom or the opening date (the First Preferred Return Date) the financing cost of the equity contribution made by HDC (the Class A Cost of Funds)
- From day after the First Preferred Return Date, until 24 months thereafter (the Second Preferred Return Date), 7% per annum
- From day after the Second Preferred Return Date, until 24 months thereafter (the Third Preferred Return Date), 8% per annum
- From day after the Third Preferred Return Date, until 24 months thereafter (the Fourth Preferred Return Date), 9% per annum
- From day after the Fourth Preferred Return Date, until 24 months thereafter (the Fifth Preferred Return Date), 10% per annum
- From day after the Fifth Preferred Return Date, until 24 months thereafter (the Sixth Preferred Return Date), 11% per annum
- From day after the Sixth Preferred Return Date, and thereafter, 12% per annum

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HDC's participation in the allocation of net profit or losses will be in proportion to relative amount allocable to each investor, except that all losses incurred prior to opening date shall be allocated to IHP and not HDC. As of June 30, 2013 total dividends in arrears on this preferred interest aggregate approximately \$57,000.

The ultimate construction of new tourism projects represents to the Company additional revenue sources from the room tax assessed on the new hotel rooms. Additionally, on those new tourism projects having casino operations, the Company also has the ability to generate additional revenues from its slot machine operation. The investment in tourism projects generated room tax and slot machine related revenues during the year ended June 30, 2013 as follows:

<u>Tourism Project</u>	<u>Room tax</u>	<u>Slot machine</u>	<u>Total</u>
DBR Dorado Owner LLC (DBR)	\$ 401,928	—	401,928
Vieques Hotel Partners (VHP)	294,073	—	294,073
Bahia Beach CH Development, LLC (Bahia Beach)	611,440	—	611,440
Condado Palm Investors, LLC (Condado Palm)	40,416	—	40,416
CCHPR Holding, LLC (CCHPR)	683,030	3,452,708	4,135,738
Old San Juan Associates LP, SE (Old San Juan)	376,917	3,447,149	3,824,066
WC Manager LLC (WC)	113,881	—	113,881
Flagship Resorts Properties, SE (Flagship)	194,153	—	194,153
District Hotel Company, LLC (DHC)	—	—	—
	<u>\$ 2,715,838</u>	<u>6,899,857</u>	<u>9,615,695</u>

(8) Interfund Balances and Transfers

The Company has the practice of pooling its cash for all governmental funds and the slot machines enterprise fund. The resulting cash balance is presented as part of the general fund.

The summary of interfund balances as of June 30, 2013, between governmental funds and enterprise funds is as follows:

<u>Received by</u>	<u>Payable by</u>	<u>Purpose</u>	<u>Amount</u>
Proprietary fund – Slot Machines Operations	Governmental funds – General fund	Balance in cash pool	\$ <u>(11,190,624)</u>

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The summary of interfund transfers for the year ended June 30, 2013 is as follows:

<u>Transfer out</u>	<u>Transfer in</u>	<u>Purpose</u>	<u>Amount</u>
Proprietary fund: Slot machines operations	Governmental fund: General fund	Distributions of slot machine operations	\$ <u>58,802,373</u>
Governmental fund – Capital projects	Governmental fund: General fund	Resources released from assignment to capital projects	\$ <u>3,849,781</u>
Governmental fund – General fund	Proprietary fund – Hotel Development Corporation	Advances not considered repayable within a reasonable time	(2,306,409)
General fund	Hotel Development Corporation	Distribution share	<u>(998,200)</u>
	Total interfund transfers – net		<u>\$ (3,304,609)</u>

(9) Transfer from Slot Machines Operations

Pursuant to Act No. 24 approved on June 26, 1997, the percentage of distributions of slot machine operations for fiscal years commencing after 2001 is computed as follows:

<u>Description</u>	<u>Casino concessionaries</u>	<u>Governmental entities</u>
Base income	34%	66%
Excess over base income	60	40

The governmental entities' participation in the operating income is as follows:

<u>Description</u>	<u>Percentage</u>
Commonwealth	15.15%
University of Puerto Rico	45.45
General fund	39.40

As of June 30, 2013, the Slot Machines Operation Fund had unremitted distributions to the Commonwealth, the University of Puerto Rico and to participants amounting to approximately \$1.9 million, \$5.8 million and \$2.1 million, respectively.

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(10) Capital Assets

Capital asset activity for the year ended June 30, 2013 was as follows:

<u>Description</u>	<u>Beginning balance (As restated)</u>	<u>Additions</u>	<u>Reductions and adjustments</u>	<u>Ending balance</u>
Governmental activities:				
Capital assets – not being depreciated:				
Land	\$ 11,394,857	—	(859,857)	10,535,000
Works of art	2,007,529	—	—	2,007,529
Total capital assets – not being depreciated	<u>13,402,386</u>	<u>—</u>	<u>(859,857)</u>	<u>12,542,529</u>
Capital assets – being depreciated:				
Infrastructure	19,528,062	—	—	19,528,062
Buildings and improvements	10,276,116	—	(538,301)	9,737,815
Leasehold improvements	1,808,052	—	—	1,808,052
Furniture and equipment	5,458,244	67,998	(680,177)	4,846,065
Vehicles	—	45,044	(13,481)	284,134
Total capital assets – being depreciated	<u>37,323,045</u>	<u>113,042</u>	<u>(1,231,959)</u>	<u>36,204,128</u>
Less accumulated depreciation:				
Infrastructure	5,680,665	687,095	—	6,367,760
Buildings and improvements	4,677,339	194,756	(538,301)	4,333,794
Leasehold improvements	1,260,967	767	—	1,261,734
Furniture and equipment	4,910,407	263,552	(666,686)	4,507,273
Vehicles	217,742	12,571	(12,800)	217,513
Total accumulated depreciation	<u>16,747,120</u>	<u>1,158,741</u>	<u>(1,217,787)</u>	<u>16,688,074</u>
Total capital assets – being depreciated – net	<u>20,575,925</u>	<u>(1,045,699)</u>	<u>(14,172)</u>	<u>19,516,054</u>
Governmental activities capital assets – net	<u>\$ 33,978,311</u>	<u>(1,045,699)</u>	<u>(874,029)</u>	<u>32,058,583</u>

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Current period depreciation expense was charged to functions of the Company as follows:

Description	Amount
Governmental activities:	
General government	\$ 1,158,741
Business-type activities – slot machines operations	38,497

On February 15, 2012, the Company agreed to sell a property known as Punta Lima for \$7.5 million. The Company received \$6 million in cash and a promissory note for \$1.5 million due in ten annual equal installments, plus interest at 6.25% (see note 6). The Company has the right to reacquire the property for \$7.5 million in the event that the buyer is unable to develop and operate a wind-based energy park or a hospitality project or if the buyer abandons the project at any time within two years following commencement of operations in December 2012. Therefore, the Company has deferred the recognition of the sale of this property through fiscal year ending June 30, 2015.

(11) Long-Term Obligations

A summary of long-term obligations for the year ended June 30, 2013 is as follows:

Description	Beginning Balance	Additions	Reductions	Ending balance	Due within one year
Governmental activities:					
Line of credit	\$ 11,569,906	4,544,025	—	16,113,931	16,113,931
Capital lease obligations	253,429	—	(187,368)	66,061	66,061
Accrued Christmas bonus	1,044,733	450,700	(584,432)	911,001	911,001
Accrued legal claims	303,400	257,604	—	561,004	—
Accrued termination benefits	6,110,126	1,890,976	(695,124)	7,305,978	593,420
Accrued compensated absences	2,950,479	2,380,013	(1,457,245)	3,873,247	496,984
Total governmental activities	\$ 22,232,073	9,523,318	(2,924,169)	28,831,222	18,181,397
Business-type activities:					
Long-term notes payable	\$ 44,483,807	—	—	44,483,807	—
Add premiums on notes refunding	911,200	—	(38,828)	872,372	—
Less deferred losses arising from notes refunding	(1,910,828)	—	116,768	(1,794,060)	—
Total long-term notes payable	43,484,179	—	77,940	43,562,119	—
Accrued compensated absences	2,310,308	1,669,417	(1,019,144)	2,960,581	274,680
Accrued Christmas bonus	491,982	267,641	(269,852)	489,771	489,771
Total business-type activities	\$ 46,286,469	1,937,058	(1,211,056)	47,012,471	764,451

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Governmental Activities

On June 15, 2011, the Company and Scotiabank de Puerto Rico entered into a credit agreement in the maximum principal amount of \$76 million (the Revolving Facility) for the following purposes:

- (i) to issue stand-by letters of credit in favor of strategic suppliers, such as airlines and cruise lines; (ii) to pay closing and incidental costs related to the transaction, and (iii) for general operating purposes, which include, without limitation (a) funding certain improvements to tourist attractions and tourism-related infrastructure, (b) capitalizing the HDC, (c) capitalizing a loan grantee fund for the development of small hospitality facilities, and (d) funding the rehabilitation of urban centers in tourist municipalities.
- a credit facility to refinance the balance of the Revolving Facility on the conversion date, which may consist of a nonrevolving term loan in the maximum principal amount of \$76 million (the Term Loan) or, at the borrower's option, (b) a stand by letter of credit (the SBLC) in the maximum principal amount of \$76 million (plus the applicable interest component) to secure a tax-exempt bond issue.

The Revolving Facility "commitment termination date" is the earlier of (i) September 13, 2013 (as extended from the original date of June 15, 2013) and (ii) the date all obligations become payable pursuant to events of default described in Section 11.1 of the agreement after the expiration of any applicable grace or cure period. The Company paid the outstanding balance of this facility during September, 2013. On January 31, 2014, the Revolving Facility agreement was amended to reduce the maximum principal amount from \$76 million to \$41 million and to extend the commitment termination date to January 31, 2016.

The Company shall pay to the arranger no later than the closing date, for the benefit of the lenders the following:

- a) Nonrefundable up-front fee equal to 30 basis points of the maximum amount of the Revolving Facility. The arranger at its discretion may offer to share the up-front fee with the participating lenders based on the amount of their commitment. The arranger reserves the right to determine the amounts of the final allocation to be made of the up-front fee among the lenders.
- b) The borrower shall pay to the agent, monthly in arrears, for the benefit of the lenders, a stand-by fee equal to 15 basis points per annum computed on the amount by which the maximum authorized amount on the Revolving Facility exceeds the average daily principal balance outstanding under the Revolving Facility.
- c) No stand-by fee shall be payable with respect to any month during which the average daily principal balance outstanding under the Revolving Facility exceeded 50% of the maximum authorized amount of the Revolving Facility.

At the Company's request and as an alternative to the Term Loan, the lenders agree, on the terms and conditions set forth in the agreement and those to be contained in a reimbursement agreement upon terms and conditions reasonably satisfactory to the lenders, to issue SBLC for the account of the Company to secure the Company's bonds. The SBLC shall be issued by the lenders on a several not joint basis, based on their participation percentage of the Term Loan. The Company shall notify the agents of its request for

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the issuance of the SBLC no later than 120 days prior to the commitment termination date. The SBLC shall mature no later than six years from issuance, and shall be in an amount not to exceed the lesser of (i) the outstanding balance of the Revolving Facility and (ii) \$76 million, plus the applicable interest component.

The agreement states that the Company must maintain certain restricted deposit accounts established by the Company with the agent for the deposit of the slot machines revenues and described in Section 9.1.8 of the agreement, which account, to the extent holding Puerto Rico Tourism Industry Development Fund (PRTIDF) revenues, shall be assigned as collateral security in favor of the lenders, and from which account the agent will transfer the available balance daily to the concentration account or, if applicable, to the Puerto Rico Horse Racing Industry and Sport Authority account.

The agreement defines “slot machine” revenues as gross revenues produced by the slot machines authorized by law to operate in hotel casinos in the Commonwealth pursuant to the Games Chance Act.

The agreement requires a debt service reserve requirement on any date before the conversion date, the higher of \$3 million and 6.5% of the principal amount outstanding under the facilities and on any date after the conversion date, the higher of \$5 million and 6.5% of the principal amount outstanding under the facilities.

The Company shall pay interest on the loans monthly in arrears on the 22nd day of each calendar month. Interest accrued from the date of each advance until the advance is paid in full. Interest on London InterBank Offered Rate (LIBOR) advances shall be computed on the basis of a year of 360 days, and interest on alternate base rate advances shall be computed on the basis of a year of 365 days, in all cases for the actual number of days elapsed.

Advances on the revolving facilities will accrue interest at a rate per annum at all times equal to 275 basis points over LIBOR or the alternate base rate, as applicable.

If at the conversion date, the Company decides to request a term loan, the applicable interest rate for the four quarters is as follows:

- a) During the first four fiscal quarters (commencing with the Company’s first fiscal quarter ending after the closing date), interest on the Term Loan will accrue at a rate per annum equal at all times to 275 basis points over LIBOR or the alternate base rate, as applicable, provided that the alternate base rate shall only be available in the circumstances stated in Section 4.4 of the agreement.

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- b) During the subsequent quarters, interest on the Term Loan will accrue at the following rates per annum, computed on the Company quarterly results on a trailing four-quarter period basis and provided that the alternate base rate shall only be available in the circumstances stated in Section 4.4 of the agreement:

<u>Debt Service Coverage Ratio</u>	<u>Applicable margin over LIBOR or alternate base rate</u>
≥3.00	225 bps
Between 2.25 and 3.00 (inclusive)	250 bps
≤2.25	275 bps

The Company will pay interest only on the Term Loans during the first 12 months following the date of the Term Loan advance, and will repay the Term Loan in 59 equal and consecutive monthly payments of principal, plus interest, commencing the 22nd day of the 13 month following the date of the Term Loan advance, plus a final balloon payment of the outstanding balance (plus accrued interest), due on the 22nd day of the month following the 59th principal installment. Each of the 59 monthly principal installments shall be the amount resulting from the application of a straight-line 300-month amortization schedule to the amount of the Term Loan.

On June 15, 2011, the Company entered into a securities control agreement among Banco Popular de Puerto Rico, acting through Popular Asset Management as intermediary, and Scotiabank de Puerto Rico. The agreement grants Scotiabank de Puerto Rico a Pledged Securities Account as collateral maintained in the Company name. As of June 30, 2013, the Company's has pledged securities amounting to approximately \$3.7 million. As of June 30, 2013, the Company's interest expense and payments on the Revolving Facility amounted to approximately \$533 thousand.

Business-Type Activities

Notes payable (the Notes) were originally composed of two loans granted by GDB, but which, pursuant to Act No. 164 of December 17, 2001 (Act No. 164), Puerto Rico Public Finance Corporation (PFC), a component unit of GDB, acquired and restructured the Notes through the issuance of its Commonwealth appropriation bonds. These bonds were issued under trust indenture agreements where PFC pledged the Notes, along with other notes under Act No. 164, to certain trustees, and created a first lien on the pledged revenue (consisting of annual Commonwealth appropriations earmarked to repay the notes) for the benefit of the bondholders.

In June 2004, PFC advance refunded a portion of certain of its outstanding Commonwealth appropriation bonds issued in 2001 under Act No. 164. HDC recognized a mirror effect of this advance refunding by PFC in its own Notes in proportion to the portion of the HDC'S Notes included in the PFC refunding. The aggregate debt service requirements of the refunding and unrefunded notes will be funded with annual appropriations from the Commonwealth.

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During the fiscal year ended June 30, 2012, PFC issued PFC 2011 Series A and B and PFC 2012 Series A bonds and refunded a portion of certain of its Commonwealth appropriation bonds issued in 2004 under Act No. 164. HDC recognized a mirror effect of this current refunding by PFC in its own notes payable in proportion to the portion of HDC'S Notes included in the PFC refundings. As a result of the PFC refundings, HDC recognized a deferred loss on defeasance, bond issuance costs, and a premium on the Notes of approximately \$1.9 million, \$453 thousand, and \$911 thousand, respectively. In addition, as part of these transactions, HDC recorded a due from Commonwealth amounting to approximately \$2.3 million at June 30, 2013, for advances made to the bond trustee to cover future debt service requirements of the refunded notes. The aggregate debt service requirements of the refunded notes in excess of the advances already made to the bond trustee will be funded with annual appropriations from the Commonwealth.

In December 2011, the Puerto Rico Sales Tax Financing Corporation (known as "COFINA" by its Spanish acronym), issued bonds and a portion of the proceeds from this bond issuance were used to cancel certain appropriation bonds of the Commonwealth and its agencies, departments, and certain component units, including approximately \$21.7 million of the Notes. As a result of this bond defeasance, the Company recognized a contribution from COFINA of approximately \$22.2 million and recognized a loss on extinguishment of debt of \$997 thousand for the year ended June 30, 2012.

The Notes' outstanding balance at June 30, 2013 was \$43.6 million and matures throughout August 1, 2031. Interest on the unpaid principal amount of the Notes is equal to the applicable percentage of the aggregate interest payable on the PFC Bonds. Applicable percentage is the percentage representing the proportion of the amount paid by the PFC on the PFC Bonds serviced by the Note to the aggregate amount paid by the PFC on all the PFC Bonds issued by the PFC under Act No. 164.

The annual debt service requirements to maturity, including principal and interest, for notes payable as of June 30, 2013, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Amount</u>
Year ending June 30:			
2014	\$ —	2,485,741	2,485,741
2015	—	2,485,741	2,485,741
2016	1,309,453	2,451,913	3,761,366
2017	1,062,250	2,414,509	3,476,759
2018	1,098,880	2,374,161	3,473,041
2019 – 2023	6,196,129	11,114,446	17,310,575
2024 – 2028	15,653,726	9,342,393	24,996,119
2029 – 2032	19,163,369	1,246,373	20,409,742
Totals	44,483,807	\$ 33,915,277	78,399,084
Less deferred losses arising from notes refunding	(1,794,060)		
Plus premium on notes refunding	872,372		
Total principal and interest maturities	\$ 43,562,119		

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(12) Voluntary Termination Benefits

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirements or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the Company. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 19 years of credited service in The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (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 Company 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 a one-month to six-month salary based on employment years. For eligible employees that choose the economic incentives and have at least 30 years of credited service in the retirement system and the age for retirement or have the age for retirement, the Company will make the employee and the employer contributions to the retirement system for a five-year period. Additionally, eligible employees that choose to participate in the early retirement benefit program or 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 Company. During the fiscal year 2013, ten employees selected early retirement. The Company accrued during the year approximately to \$1.9 million for termination benefits.

Employee and employer contributions to the Retirement System and the employee annuity for the applicable period were discounted based on the yield of the Company's money market account. As of June 30, 2013, the total liability of approximately \$7.3 million related to these benefits was included as part of other accrued long-term liabilities in the accompanying statement of net position.

(13) Retirement System

(a) *Defined-Benefit Pension Plan*

The Retirement System is a cost-sharing multiple-employer defined-benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth.

The Retirement System was created under Act No. 447 (the Act), approved on May 15, 1951, as amended, and became effective on January 1, 1952. All regular appointed and temporary employees of the Company hired before January 1, 2000, under 55 years of age at the date of employment became members of the Retirement System as a condition of their employment. No benefits are payable if the participant receives a refund of accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits generally vest after 10 years of plan participation. Disability benefits are available to members for occupational and nonoccupational disabilities.

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However, a member must have at least 10 years of service to receive nonoccupational disability benefits.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by the Retirement System. The annuity, for which a plan member is eligible, is limited to a minimum of \$400 per month and a maximum of 75% of the average compensation.

Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Company	9.275% of applicable payroll
Employees:	
Hired on or before March 31, 1990	5.775% of monthly gross salary for the first \$550 8.275% of monthly gross salary for the excess over \$550
Hired on or after April 1, 1990	8.275% of monthly gross salary

On April 4, 2013, the Governor signed into law Act 3 of 2013 (Act 3), which adopted a comprehensive reform of the Retirement System, that is funded primarily with budget appropriations from the Commonwealth's General Fund.

With the enactment of Act 3, and taking into account an additional annual contribution of \$140 million for the next 20 years by the Commonwealth, its expected that the cash funding shortfall of the Retirement System will be eliminated in the long term. The Act, however, does not eliminate the need for the Commonwealth to make additional contributions to the Retirement System.

(b) System 2000

On September 24, 1999, an amendment to the Act, which created the Retirement System, was enacted to provide a new benefit structure, similar to a cash balance plan, known as System 2000.

Employees participating in the Retirement System as of December 31, 1999 were allowed to stay in the defined benefit structure or transfer to System 2000. Employees joining the public sector on or after January 1, 2000, are only allowed to become members of System 2000. Under System 2000, contributions received from participants and employees are pooled and invested by the Retirement System, together with the assets corresponding to the defined benefit structure. There are no separate accounts for System 2000 participants. Future benefit payments under the original defined benefit structure and System 2000 will be paid from the same pool of assets.

The annuity is based on a formula, which assumes that each year the participants' contribution (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account, which will either (1) earn a fixed rate based on the two-year constant maturity treasury notes, (2) earn a rate equal to 75% of the return of the

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Retirement System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Disability benefits are not granted under System 2000. The employers' contribution amounts to 9.275% of the employee's salary. System 2000 reduces the retirement age from 65 years to 60 years for those employees who joined the public sector on or after January 1, 2000.

On July 6, 2011, Act No. 116 was approved to increase the employer's contributions for each participant and the employees' contributions. Starting on July 1, 2011, the employer's contribution will be 10.275% and will increase annually by 1% until June 30, 2016. Effective July 1, 2016, the employer's contribution will increase by 1.25% annually until reaching 20.25%. The employees' contributions will be 10.25% of monthly gross salary.

Total employee contributions to the Retirement System, including System 2000, for the year ended June 30, 2013, amounted to approximately \$1.3 million. The Company's contributions for the years ended June 30, 2013, 2012, and 2011, amounted to approximately \$1.8 million, \$1.4 million, and \$1.5 million, respectively, equal to the required annual contributions.

On April 4, 2013, the Commonwealth enacted Act No. 3 to amend the Act and restructure the Retirement System. The main amendments under Act No. 3, include the freezing of benefit accruals of all participants under the defined benefit structure of the Retirement System, an increase in the retirement age of all participants, and an increase in the mandatory employee contributions to 10% of their monthly gross salary, among others. The provisions of Act No. 3 are effective on July 1, 2013.

Additional information on the Retirement System is provided in its stand-alone basic financial statements for the year ended June 30, 2013, a copy of which can be obtained from the Commonwealth of Puerto Rico Government Employees and Judiciary Retirement System Administration, 437 Ponce De León Avenue, Hato Rey, Puerto Rico 00918.

(c) *Postemployment Benefits*

The Company provides to certain employees covered under a collective bargaining agreement, a postemployment benefit that includes six months of medical insurance after voluntary termination under an early retirement termination plan. Information and related accruals required under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, has not been included in the accompanying financial statements since the required information is not readily available. Management asserts that additional disclosures and the effect on the financial statement effect are not considered significant, considering the limited number of employees that are covered under this agreement.

(14) Related-Party Transactions

Governmental Activities

As of June 30, 2013, amounts due to the Commonwealth and to Puerto Rico Convention Center District Authority, a component unit of the Commonwealth, were approximately \$6.4 million and \$4.2 million, respectively, and are related to unremitted distributions of hotel room taxes collected.

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During the year ended June 30, 2013, the Company received contributions from the Commonwealth amounting to \$25,000. On June 28, 2010, the Company entered into a management fees agreement with the Department of Economic Development and Commerce of the Commonwealth for strategic planning, interagency coordination, project management, promotion assistance, incentive administration, legal counseling, communication coordination, and administration of travel, contracts, hiring, and promoting. Management fees under this agreement for the year ended June 30, 2013 amounted to approximately \$5.3 million.

Business-Type Activities

As of June 30, 2013, amounts due from the Commonwealth of approximately \$2.3 million are related to advances made to the bond trustee from the proceeds of the notes refunded to cover future debt service requirements of the refunded notes (see note 11).

During the year ended on June 30, 2013, the Company contributed approximately \$22.6 million and \$67.8 million to the Commonwealth and the University of Puerto Rico, respectively, related to slot machine distributions.

(15) Hotel Room Tax

Act No. 272 of September 9, 2003, approved the transfer of the imposition and collection of hotel room taxes pursuant to Sections 2051 and 2084 of the 1994 Puerto Rico Internal Revenue Code, and the related responsibilities of administering, supervising, and regulating such tax imposition and collection from the Treasury Department to the Company. Act No. 272, as amended by Act No. 23 of March 12, 2008, imposes a general tax of 9% based on the proceeds received from room charges on hostelries and an 11% tax for those operating casinos.

However, special treatment is given to hostelries falling into the following categories:

- Motels (tax of 9% if the daily rate exceeds \$5)
- “Paradores,” all inclusive, and short-term rentals (tax of 7%)
- Recreation facilities operated by the Commonwealth, except for those operated by Puerto Rico National Parks Company (tax of 5%)

Act No. 272 also redefined the formula for the distribution of hotel room tax in the following manner beginning in fiscal year 2004:

- The necessary amounts determined and certified by GDB before the beginning of each fiscal year to the Company and Puerto Rico Convention Center District Authority (the Authority) to cover the principal and interest payment of the Authority’s debt with GDB or any other related debt applicable to the development and construction of the Puerto Rico Convention Center, would be deposited in a special account to be held by GDB in the name of the Authority.

On March 23, 2006, the Authority refinanced its then existing debt with GDB for the development and construction of the Puerto Rico Convention Center and surrounding district through a \$482.6 million bond

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issuance. During the year ended June 30, 2013, the Company transferred the amount of approximately \$30.3 million to the Authority to cover the debt service of the outstanding balance of bonds payable.

- The excess over the necessary amounts determined to cover the debt service referred to above shall be distributed in the following priority orders:
 - Two percent of the total proceeds will be assigned to the general fund of the Company to cover the operating and distribution costs of implementing the new law, or for any other use established by the Company.
 - Five percent of the total proceeds will be assigned to the general fund of the Commonwealth up to the year ended June 30, 2007, and to the Puerto Rico National Parks Company commencing during the year ended June 30, 2008. Beginning with the year in which the Authority certifies to the Treasury Department and the Company, the start of operations of the Authority and for the subsequent 10 years, this 5% will be available to finance any deficit arising from the operations of the Puerto Rico Convention Center in excess of the \$2.5 million reserve that the Company will maintain as established below.
 - Nine percent of the proceeds will be transferred to the Puerto Rico Convention Bureau (a third party), but this amount will not be less than \$4.5 million.
 - Up to \$2.5 million of the proceeds will be maintained by the Company in a special reserve account to cover any deficit of the Authority's operations beginning with the commencing of operations of the Authority and for the subsequent 10 years. After conclusion of this period, the proceeds shall be transferred to the Puerto Rico National Parks Company.
 - Any proceeds over the previous distribution will be retained by the Company, up to \$20 million. The Company shall transfer to the Puerto Rico National Parks Company 50% of the excess over the \$20 million of proceeds received by the Company.

During the year ended June 30, 2013, hotel room taxes collected amounted to approximately \$65.6 million. Distributions for the year ended June 30, 2013 were approximately as follows (amounts in thousands):

	Amount
Entity/Fund	
Authority – debt repayment	\$ 30,335
Authority – reserve for deficit	2,500
Authority – reserve for deficit in excess of \$2,500	1,720
Puerto Rico Convention Bureau	4,500
Puerto Rico National Parks Company	2,500
Total hotel room tax distributed to others	41,555
General fund of the Company	22,496
Total hotel room tax distributions	\$ 64,051

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Hotel room taxes distributed to others has been recorded as part of the general government expense/expenditure function in the accompanying statement of activities and statement of changes in revenues, expenditures, and changes in fund balances – governmental funds.

(16) Commitments and Contingencies

(a) Commitments

On August 8, 2003, HDC and International Hospitality Enterprises, Inc., entered into a development agreement (the Development Agreement), which on the same date was assigned and assumed by the International Hospitality Associates, S. en C. por A. (S.E.) (the Partnership), with respect to the planning, design, construction, and development of the Condado Vanderbilt Hotel and La Concha Hotel, including the construction of three additional condo-hotel structures (the Project).

Commencing on the rental commencement date, the Partnership is to pay annual rent of \$500 thousand (basic rental) under each lease, in equal monthly installments, in advance. In addition, the Partnership must pay rent of 3.5% of the amount by which gross hotel room sales for any year exceeds \$500 thousand. The Development Agreement contains a definition of gross hotel room sales, which, among other things, excludes rentals of the condo-hotel units.

The deed of land rights shall be for perpetuity as required by law. The land rights are limited to the full superficial area of the parcels to be identified, projecting vertically upwards to the height of 16 stories above the ground, including a three-story base, and vertically downward up to 27.5 meters. The price for the land rights shall be calculated at \$2 thousand per square meter, as reflected in an appraisal prepared by appraisal experts.

On July 31, 2007, and August 8, 2007, HDC entered into certain amendments to La Concha Hotel and Condado Vanderbilt Hotel lease agreements, respectively, as follows:

Opening Date – For La Concha Hotel, the opening date was established to be November 30, 2007, or the first day of the month following the date the parking and the La Concha Hotel opens to the public, but not later than March 31, 2008. For Condado Vanderbilt Hotel, the opening date was established to be January 2, 2011, or the date the first day of the month following the date the parking structure and the Condado Vanderbilt Hotel open to the public.

Rental Commencement Date – For both rental agreements, the rental commencement date was established to be the first day of the month following the second anniversary of the opening date.

Preopening Basic Rental – During the period beginning with the commencement date and ending on the opening date, there shall be an accrual of preopening basic rental equal to the flat sum of \$180 thousand. Such preopening basic rental shall be paid in five equal annual installments, with the first installment becoming due and payable on the opening date, and the remaining four annual installments on the first day of each subsequent rental year. As of June 30, 2013, preopening basic rental receivable amounted to approximately \$180 thousand.

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Basic Rental – For both rental agreements, a basic annual rental of \$330 thousand shall be paid in advance, in equal monthly installments, the first of such installments being due and payable on the second anniversary of the rental commencement date and the subsequent installments being due and payable on the same day of each subsequent month thereafter throughout the lease term. At any time during the first three rental years, the Partnership may repay the basic rental up to 12 rental years. As of June 30, 2013, basic rental receivable amounted to approximately \$1.1 million.

Percentage Rate – For both rental agreements, an annual percentage rate shall be paid by the Partnership in the amount by which 3.5% of gross hotel room sales for any rental year exceeds (i) the basic rental payable to HDC with respect to that rental year under the lease, plus (ii) the basic rental payable to HDC under La Concha Parking Parcel lease between the Partnership and HDC. The percentage rent shall be payable within 30 days after the end of each rental year. As of June 30, 2013, the annual percentage rent receivable amounted to approximately \$1.4 million.

On August 8, 2007, HDC and the Partnership entered into certain amendments to La Concha Parking Parcel lease agreement, as follows:

Opening Date – The opening date was established to be November 30, 2007, or the first day of the month following the date the parking structure and the La Concha Hotel opens to the public.

Rental Commencement Date – The rental commencement date was established to be the first day of the month following the second anniversary of the opening date.

Rental Year – The rental year was defined as each year during the term. The first year commencing on the opening date and terminating on the date prior to the first anniversary of the opening date and each succeeding year commencing on the same date and terminating on the same date as the anniversary of the termination date of the following year.

On August 8, 2007, HDC also entered into a deed of La Concha Hotel and Condado Vanderbilt Parking Parcel Lease with the Partnership with a basic annual rental of \$170 thousand that shall be paid by the Partnership in equal monthly installments, the first of such installments being due on the rental commencement date and subsequent installments being due on the same date of each subsequent month thereafter throughout the lease term. As of June 30, 2013, parking fee receivable amounted to approximately \$439 thousand. Under the Settlement Agreement (See Note 6,) the Developer paid HDC on March 10, 2014 a lump sum in an amount equal to \$1.7 million in complete and full satisfaction of outstanding rent owed by the Partnership.

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(b) Other Rental Commitments

The Company is also committed to several noncancelable operating leases for various facilities that expire in various years through 2023. Some of the lease contracts contain renewal options. During the year ended June 30, 2013, rent expense of these operating leases amounted to approximately \$1.2 million.

	Amount
Year ending June 30:	
2014	\$ 710,339
2015	668,675
2016	597,962
2017	597,962
2018	597,962
2019 – 2023	370,264
Total	\$ 3,543,164

The Company has a lease agreement with the Puerto Rico Industrial Development Company, a component unit of the Commonwealth, for office space rented in Manhattan, New York. The sublease payments are in proportion to the percentage of occupation of the Company, which was determined to be 27.78%. The sublease agreement expires on December 31, 2022. During the year ended June 30, 2013, the rent expense related to this sublease agreement amounted to approximately \$233 thousand. Future minimum lease commitments are as follows:

	Amount
Year ending June 30:	
2014	\$ 245,316
2015	245,316
2016	245,316
2017	245,316
2018	251,395
2019 – 2023	1,158,632
Total	\$ 2,391,291

(c) Contingencies

On November 29, 2000, the Company transferred certain assets and liabilities to PRISMA Zona Exploratoria de Puerto Rico. In connection with this transaction, the Company is a defendant or codefendant in various lawsuits arising out of PRISMA Zona Exploratoria de Puerto Rico's operations. In addition, the Company also obtained the annulment of the transfer of net position from PRISMA to PRISMA Zona Exploratoria de Puerto Rico. On July 2, 2008, a plaintiff brought an action against the Company for approximately \$303 thousand for monies owed in connection with

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the work performed on behalf of PRISMA. The Company answered the complaint and denied the claim alleging that it should not be held liable for the obligations of PRISMA. As of June 30, 2013, the Company has recorded a liability for accrued legal claims of approximately \$140 thousand.

On June 15, 2009, a service provider sued the Company for approximately \$4.5 million. It claims the Company breached three agreements related to the creation, support, and maintenance of a slot alarm monitoring system for casinos. The Company has answered the complaint and denied all allegations. This lawsuit has different claims, wrongful termination, unreturned equipment, diminishing plaintiff's capacity to generate income for not returning equipment, damages, and unjust enrichment. In the discovery stage, the service provider was not able to present evidence for the claims of damages and unjust enrichment. Management believes that the ultimate resolution of this case will not have a material impact on the Company's financial position.

On July 15, 2010, the plaintiff sued the Company for alleged violation of plaintiff's rights to due process before canceling the plaintiff's license to operate as a travel agency in Puerto Rico. In the complaint, the plaintiff requested an amount of \$3 million for damages caused to its business goodwill and \$1.5 million for economic damages and mental anguish. The Company answered the complaint and denied all claims and allegations. Management believes that the ultimate resolution of this case will not have a material impact on the Company's financial position.

On February 22, 2010, the plaintiff sued the Company for alleged breach of contract and tortious interference with contractual obligations, for which the plaintiff sought \$1.5 million in damages. The Company answered the complaint and denied all claims and allegations. Currently, a request for Certiorari is pending before the Supreme Court of Puerto Rico, whereby an order for a preliminary injunction hearing issued by the Court of Appeals is being contested. The parties have entered into conversations regarding a potential transaction in this case. The outcome of this case and the potential loss, if any, cannot be reasonably ascertained as of June 30, 2013.

The Company is also involved in various labor-related claims and legal actions. Management of the Company understands that the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position and/or results of operations.

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(17) Fund Balance of the General Fund

Fund balance as of June 30, 2013, consists of the following:

Nonspendable:	
Prepaid expenses and other assets	\$ 69,351
Note receivable	1,350,000
Restricted-debt service	3,717,689
Committed:	
Advertising and promotion	23,020,402
Tourism development	6,584,170
Chartered flights incentives	2,000,000
Unassigned	<u>(33,802,483)</u>
Total	<u>\$ 2,939,129</u>

(18) Subsequent Events

On July 24, 2013, the Commonwealth enacted Law No. 80, Law for the Development of the Cruise Ship of Puerto Rico, (Act No. 80) providing for the transfer to the Company all funds and activities of cruise ship incentives previously administered by the Puerto Rico Ports Authority (the Ports Authority) another component unit of the Commonwealth. Accordingly, the Company is now the administrator of the cruise ship incentives program of the Commonwealth. Act No. 80 establishes that after June 30, 2013, the Ports Authority shall transfer to the Company any remaining balances of an incentives fund, and that the Company will now administer and grant the cruise ship incentives program. Act No. 80 provides that the cruise ship incentives fund shall be financed with transfers from the Company's own funds and with Commonwealth appropriations of \$5.5 million, each, for the year ending June 30, 2014. For fiscal years ending on June 30, 2015 through June 30, 2018, the Company shall make annual transfers of approximately \$6.25 million, and the Commonwealth shall make annual appropriations of \$6.5 million.

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Combining Schedule - Balance Sheet - General Fund

June 30, 2013

Assets	<u>General</u>	<u>Promotions</u>	<u>Tourism development</u>	<u>Eliminating entries</u>	<u>Total general fund</u>
Cash and cash equivalents	\$ 13,901,450	—	—	—	13,901,450
Investments	37,945,255	—	—	—	37,945,255
Accounts receivable:					
Hotel room taxes – net	5,907,327	—	—	—	5,907,327
Other	504,062	—	—	—	504,062
Prepaid expenses and other assets	69,351	—	—	—	69,351
Note receivable	1,350,000	—	—	—	1,350,000
Due from other funds	—	24,940,705	11,362,937	(36,303,642)	—
Total assets	<u>\$ 59,677,445</u>	<u>24,940,705</u>	<u>11,362,937</u>	<u>(36,303,642)</u>	<u>59,677,445</u>
Liabilities and Fund Balances					
Liabilities:					
Accounts payable	\$ 20,004,894	1,920,303	2,778,767	—	24,703,964
Unearned revenue	7,503,774	—	—	—	7,503,774
Other liabilities	2,773,907	—	—	—	2,773,907
Due to Puerto Rico Convention Center District Authority	4,177,949	—	—	—	4,177,949
Due to Commonwealth of Puerto Rico	6,388,098	—	—	—	6,388,098
Due to other funds	47,494,266	—	—	(36,303,642)	11,190,624
Total liabilities	<u>88,342,888</u>	<u>1,920,303</u>	<u>2,778,767</u>	<u>(36,303,642)</u>	<u>56,738,316</u>
Fund balances:					
Nonspendable	1,419,351	—	—	—	1,419,351
Restricted	3,717,689	—	—	—	3,717,689
Committed	—	23,020,402	8,584,170	—	31,604,572
Unassigned (deficit)	(33,802,483)	—	—	—	(33,802,483)
Total fund balances (deficit)	<u>(28,665,443)</u>	<u>23,020,402</u>	<u>8,584,170</u>	<u>—</u>	<u>2,939,129</u>
Total liabilities and fund balances	<u>\$ 59,677,445</u>	<u>24,940,705</u>	<u>11,362,937</u>	<u>—</u>	<u>59,677,445</u>

See accompanying independent auditors' report.

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Combining Schedule of Revenues, Expenditures, and Changes in Fund Balances - General Fund

Fiscal year ended June 30, 2013

	<u>General</u>	<u>Promotions</u>	<u>Tourism development</u>	<u>Eliminating entries</u>	<u>Total general fund</u>
Revenues:					
Hotel room taxes	\$ 65,641,949	—	—	—	65,641,949
Commonwealth of Puerto Rico appropriations	25,000	—	—	—	25,000
Charges for programs and services	1,175,086	—	68,998	—	1,244,084
Investment earnings	375,946	—	—	—	375,946
Total revenues	<u>67,217,981</u>	<u>—</u>	<u>68,998</u>	<u>—</u>	<u>67,286,979</u>
Expenditures:					
Current:					
General government	69,385,303	—	—	—	69,385,303
Advertising and promotion	11,204,910	11,003,318	19,420,944	—	41,629,172
Programs and services	633,682	—	1,484,292	—	2,117,974
Public relations	1,510,021	777,000	—	—	2,287,021
Capital outlays – general government	113,042	—	—	—	113,042
Total expenditures	<u>82,846,958</u>	<u>11,780,318</u>	<u>20,905,236</u>	<u>—</u>	<u>115,532,512</u>
Deficiency of revenues over expenditures	<u>(15,628,977)</u>	<u>(11,780,318)</u>	<u>(20,836,238)</u>	<u>—</u>	<u>(48,245,533)</u>
Other financing sources (uses):					
Proceeds from line of credit	4,544,025	—	—	—	4,544,025
Sales of capital assets	5,944,446	—	—	—	5,944,446
Transfers in	42,354,888	22,495,595	21,797,266	(23,995,595)	62,652,154
Transfers out	(27,300,204)	—	—	23,995,595	(3,304,609)
Total other financing sources – net	<u>25,543,155</u>	<u>22,495,595</u>	<u>21,797,266</u>	<u>—</u>	<u>69,836,016</u>
Net change in fund balances	9,914,178	10,715,277	961,028	—	21,590,483
Fund balances (deficit) – beginning of year (as restated, see Note 2)	<u>(38,579,621)</u>	<u>12,305,125</u>	<u>7,623,142</u>	<u>—</u>	<u>(18,651,354)</u>
Fund balances (deficit) – end of year	<u>\$ (28,665,443)</u>	<u>23,020,402</u>	<u>8,584,170</u>	<u>—</u>	<u>2,939,129</u>

See accompanying independent auditors' report.