# ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information

June 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

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# Independent Auditors' Report

The Audit Committee
Economic Development Bank for Puerto Rico:

## *Report on the Financial Statements*

We have audited the accompanying financial statements of the business-type activities, the major fund and the remaining fund information of Economic Development Bank for Puerto Rico (the Bank), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2014 and 2013, which collectively comprise the Bank'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 audits. We conducted our audits 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 business-type activities, the major fund and the remaining fund information of Economic Development Bank for Puerto Rico as of June 30, 2014 and 2013, and the respective changes in its financial position and cash flows thereof for the years then ended, in accordance with U.S. generally accepted accounting principles.

***Other Matters***

*Required Supplementary Information*

U.S. generally accepted accounting principles require that the management’s discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

October 22, 2014

Stamp No. E137608 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report

This financial discussion contains an analysis of the statements of net position of the Economic Development Bank for Puerto Rico (the Bank) as of June 30, 2014 and 2013, and its changes in net position for the years then ended. The information included in this section should be read in conjunction with the basic financial statements of the Bank and its notes.

The business-type activities of the Bank are accounted for as enterprise funds, which include the activities of the Bank's principal operating fund and those of the Bank's blended component unit, Economic Development Bank Capital Investment (EDBCI). EDBCI was created to account for and focus separately on the activities and investments in local equity and venture capital funds. The required financial statements for an enterprise fund are as follows: statement of net position; statement of revenue, expenses, and changes in net position; and statement of cash flows. These financial statements report information using accounting methods similar to those used by private financial institutions.

The statement of net position includes all the Bank's assets and liabilities, classified as current, noncurrent, capital assets, and net position. This statement provides information as of a specific date about the nature and amount of investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for evaluating the Bank's capital structure.

The statement of revenue, expenses, and changes in net position includes revenue earned and expenses incurred by the Bank for a specific period of time (12 operating months beginning on July 1 and ending on June 30). This statement measures the results of the Bank's operation and can be used to determine whether the Bank has successfully recovered all its costs through user fees and other charges. This statement distinguishes interest and noninterest revenue and expenses.

The statement of cash flows reports cash receipts, cash payments, and changes in cash resulting from operations, noncapital financing, capital and related financing, and investing activities. This statement provides information about the Bank's cash flows and how cash is obtained, used, and what was the change in cash balance during the reporting period beginning on July 1 and ending on June 30.

**Financial Highlights**

- Gross loan portfolio increased $35.1 million in 2014 or 11.3%, from $309.5 million in 2013 to $344.6 million in 2014.
- Interest income from loans amounted to $15.3 million in 2014, a $1 million or approximately 7.2% increase from $14.3 million in 2013.
- Net income increased $3.3 million in 2014 or 130.2%, from 2.6 million in 2013 to $5.9 million in 2014.

### Comparison of 2014 and 2013 Assets, Liabilities, and Net Position

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

| | | | Increase (decrease) | |
|---|---|---|---|---|
| **Net position** | **2014** | **2013** | **Amount** | **Percentage** |
| Current assets | $ 339,895 | 143,231 | 196,664 | 137.31% |
| Noncurrent assets | 750,350 | 1,151,936 | (401,586) | (34.86) |
| Total assets | 1,090,245 | 1,295,167 | (204,922) | (15.82) |
| Current liabilities | 468,298 | 416,792 | 51,506 | 12.36 |
| Noncurrent liabilities | 455,950 | 718,293 | (262,343) | (36.52) |
| Total liabilities | 924,248 | 1,135,085 | (210,837) | (18.57) |
| Net position: | | | | |
| Net investment in capital assets | (110) | (530) | 420 | 79.25 |
| Restricted for special loan programs | 18,077 | 13,259 | 4,818 | 36.34 |
| Unrestricted | 148,030 | 147,353 | 677 | 0.46 |
| Net position | $ 165,997 | 160,082 | 5,915 | 3.69 |

At June 30, 2014, the Bank's total assets were $1,090.2 million ($57.9 million from EDBCI) compared to $1,295.2 million at June 30, 2013 ($286.4 million from EDBCI). The decrease of $205 million represents 15.8% of the 2013 total assets balance.

Total loan portfolio increased by 11.3% when compared to balances as of June 30, 2013. Loan disbursements decreased from $191.9 million in 2013 to $177.5 million in 2014, while principal collected on loans decreased from $143.7 million for fiscal year 2013 to $127.5 million for fiscal year 2014. The related allowance for loan losses decreased by $1.7 million or 4.8% of the 2013 balance. The net loan portfolio increased by $36.8 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell decreased by $242.1 million when compared to balances as of June 30, 2013, mainly due to a decrease of $261.8 million in promissory notes.

At June 30, 2014, the Bank's total liabilities were $924.2 million compared to $1,135.1 million at June 30, 2013. The decrease of $210.9 million represents 18.6% of the 2013 total liabilities.

Total time deposits were $411.7 million as of June 30, 2014. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $390.3 million. Deposits from other financial institutions were $21.4 million. Total time deposits increased by $81.4 million. As of year-end, the total promissory notes and other note payable balance was $450.1 million.

Securities sold under agreement to repurchase decreased by $30.5 million, from $76.2 million in 2013 to $45.7 million in 2014. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.


(Continued)

The Bank's net position was $166 million at June 30, 2014, an increase of $5.9 million or 3.7% when compared to June 30, 2013. Additional information about net position composition is presented in note 11 to the basic financial statements.

**Comparison of 2014 and 2013 Revenue, Expenses, and Changes in Net Position**

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

| Revenue, expenses, and changes in net position | | 2014 | 2013 | Increase (decrease) Amount | Increase (decrease) Percentage |
|---|---|---|---|---|---|
| Interest income from loans | $ | 15,293 | 14,268 | 1,025 | 7.18% |
| Interest income from investments | | 35,832 | 53,562 | (17,730) | (33.10) |
| Total interest income | | 51,125 | 67,830 | (16,705) | (24.63) |
| Total noninterest income | | 2,918 | 1,075 | 1,843 | 171.44 |
| Total operating revenue | | 54,043 | 68,905 | (14,862) | (21.57) |
| Provision for loan losses | | 10,960 | 10,788 | 172 | 1.59 |
| Total interest expense | | 29,559 | 44,102 | (14,543) | (32.98) |
| Total noninterest expenses | | 12,425 | 13,903 | (1,478) | (10.63) |
| Total operating expenses | | 52,944 | 68,793 | (15,849) | (23.04) |
| Operating income | | 1,099 | 112 | 987 | 881.25 |
| Capital contribution | | 4,816 | 2,458 | 2,358 | 95.93 |
| Net income and change in net position | $ | 5,915 | 2,570 | 3,345 | 130.16 |

For the year ended June 30, 2014, the Bank presents an operating income of $1.1 million when compared to the operating income of $112,000 for the year ended June 30, 2013. The increase in operating income resulted from the net effect of the following:

***(a) Interest Income***

Total interest income decreased by approximately 24.6% or $16.7 million, from $67.8 million in 2013 to $51.1 million in 2014. This decrease in interest income was mainly the result of decreased average transaction volumes during the fiscal year, with basically no change in average interest rates.

***(b) Noninterest Income***

Noninterest income increased by approximately $1.8 million, from $1.1 million in fiscal year 2013 to $2.9 million income in 2014. This increase was mainly due to an increase in the net realized and unrealized gains on investments of $2.1 million.

The increase in the net realized and unrealized gains on investment results from the combined effect of a $894,000 decrease in net unrealized gains of investment securities and a $3 million increase in net realized gains from the disposition of investments.

### *(c) Provision for Loan Losses*

Compared to 2013, the provision for loan losses shows an increase of $172,000. Impaired loans requiring an allowance for losses decreased by $4.7 million, from $47 million in 2013 to $42.3 million in 2014, and the specific reserve for these decreased by $1.7 million, from $15.3 million to $13.6 million. As a percentage of the total loans portfolio, impaired loans represent 28.1% and 28% at June 30, 2014 and 2013, respectively. Loans charged off during fiscal year 2014 increased by $5.4 million when compared to 2013, from $9.5 million in 2013 to $14.9 million in 2014. As a percentage of the total loans portfolio, the allowance for loan losses represents 9.9% and 11.5% at June 30, 2014 and 2013, respectively.

Loan collections decreased from $143.7 million during fiscal year 2013 to $127.5 million for fiscal year 2014.

### *(d) Interest Expense*

Total interest expense decreased by 33% or $14.5 million, from $44.1 million in 2013 to $29.6 million in 2014. This decrease in interest expense was the result of decreased average principal balances owed.

### *(e) Noninterest Expenses*

Noninterest expenses decreased by approximately $1.5 million or 10.6% during fiscal year 2014. This decrease in noninterest expenses resulted from the net effect of the following:

- Provision for losses on loan guarantees decreased from $1,062,000 in 2013 to $16,000 in 2014. The decrease is due to a reduction in loan guarantees paid under the Loan Guarantee Program created by Law No. 9 of the Commonwealth of Puerto Rico in May 9, 2009. Funds for payment of these guarantees were assigned to the Bank under Executive Order OE-2010-005, recorded as a reserve for possible losses on loan guarantees and reclassified to capital contribution in the statement of revenue, expenses, and changes in net position for the year ended June 30, 2014.
- Provision for foreclosed assets decreased 10% or $100,000, from $1 million in 2013 to $900,000 in 2014.
- Salaries and employee benefits decreased by 3.6% or $319,000, from approximately $8.9 million in 2013 to approximately $8.6 million in 2014. The decrease is mainly due to a decrease in total headcount.
- Occupancy and related expenses (including deprecation) decreased by 6.2% or $47,000, from approximately $754,000 in 2013 to approximately $707,000 in 2014.

- Advertising expense increased by 2.5% or $6,000, from approximately $257,000 in 2013 to approximately $263,000 in 2014.
- Professional fees increased by 22.6% or $70,000, from approximately $312,000 in 2013 to approximately $382,000 in 2014. The increase is mainly due to an increase in other professional services during 2014, mainly consultants for the Credit area.
- All other noninterest expenses decreased by approximately $44,000 as compared to fiscal year 2014.

**Comparison of 2013 and 2012 Assets, Liabilities, and Net Position**

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

| Net position | 2013 | 2012 | Increase (decrease) Amount | Increase (decrease) Percentage |
|---|---|---|---|---|
| Current assets | $ 143,231 | 378,109 | (234,878) | (62.12)% |
| Noncurrent assets | 1,151,936 | 1,200,981 | (49,045) | (4.08) |
| Total assets | 1,295,167 | 1,579,090 | (283,923) | (17.98) |
| Current liabilities | 416,792 | 700,779 | (283,987) | (40.52) |
| Noncurrent liabilities | 718,293 | 720,798 | (2,505) | (0.35) |
| Total liabilities | 1,135,085 | 1,421,577 | (286,492) | (20.15) |
| Net position: | | | | |
| Net investment in capital assets | (530) | (710) | 180 | 25.35 |
| Restricted for special loan programs | 13,259 | 13,158 | 101 | 0.77 |
| Unrestricted | 147,353 | 145,065 | 2,288 | 1.58 |
| Net position | $ 160,082 | 157,513 | 2,569 | 1.63 |

At June 30, 2013, the Bank's total assets were $1,295.2 million ($286.4 million from EDBCI) compared to $1,579.1 million at June 30, 2012 ($323.1 million from EDBCI). The decrease of $283.9 million represents 18% of the 2012 total assets balance.

Total loan portfolio increased by 38.8% when compared to balances as of June 30, 2012. Loan disbursements increased from $145.2 million in 2012 to $191.9 million in 2013, while principal collected on loans increased from $113.8 million for fiscal year 2012 to $143.7 million for fiscal year 2013. The related allowance for loan losses increased by $4.7 million or 15.3% of the 2012 balance. The net loan portfolio increased by $34.1 million.

Interest-bearing deposits with other banks, commercial paper, investments, and securities purchased under agreements to resell decreased by $319.8 million when compared to balances as of June 30, 2012, mainly due to a $213.3 million decrease in time deposits, a decrease of $47.7 million in securities sold under agreement to repurchase, a decrease of $25.6 million in promissory notes and an increase in net loans portfolio of $34.1 million.

At June 30, 2013, the Bank's total liabilities were $1,135.1 million compared to $1,421.6 million at June 30, 2012. The decrease of $286.5 million represents 20.2% of the 2012 total liabilities.

Total time deposits were $330.3 million as of June 30, 2013. Time deposits consist primarily of certificates of deposit of public funds from other governmental institutions, which totaled $290 million. Deposits from other financial institutions were $40.3 million. Total time deposits decreased by $213.3 million. As of year-end, the total promissory notes and other note payable balance was $712.5 million.

Securities sold under agreement to repurchase decreased by $47.7 million, from $123.9 million in 2012 to $76.2 million in 2013. Fluctuations in these securities are due to specific market conditions, which provide the Bank with funds and investment opportunities to generate net revenue.

The Bank's net position was $160.1 million at June 30, 2013, an increase of $2.6 million or 1.6% when compared to June 30, 2012. Additional information about net position composition is presented in note 11 to the basic financial statements.

**Comparison of 2013 and 2012 Revenue, Expenses, and Changes in Net Position**

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

| Revenue, expenses, and changes in net position | 2013 | 2012 | Increase (decrease) Amount | Percentage |
|---|---|---|---|---|
| Interest income from loans | $ 14,268 | 12,156 | 2,112 | 17.37% |
| Interest income from investments | 53,562 | 55,389 | (1,827) | (3.30) |
| Total interest income | 67,830 | 67,545 | 285 | 0.42 |
| Total noninterest income | 1,075 | 1,537 | (462) | (30.06) |
| Total operating revenue | 68,905 | 69,082 | (177) | (0.26) |
| Provision for loan losses | 10,788 | 8,600 | 2,188 | 25.44 |
| Total interest expense | 44,102 | 46,443 | (2,341) | (5.04) |
| Total noninterest expenses | 13,903 | 12,414 | 1,489 | 11.99 |
| Total operating expenses | 68,793 | 67,457 | 1,336 | 1.98 |
| Operating income | 112 | 1,625 | (1,513) | (93.11) |
| Capital contribution | 2,458 | 8,710 | (6,252) | (71.78) |
| Net income and change in net position | $ 2,570 | 10,335 | (7,765) | (75.13) |

For the year ended June 30, 2013, the Bank presents an operating income of $112,000 when compared to the operating income of $1.6 million for the year ended June 30, 2012. The decrease in operating income resulted from the net effect of the following:

***(f) Interest Income***

Total interest income increased by approximately 0.4% or $285,000, from $67,545 thousand in 2012 to $67,830 thousand in 2013. This increase in interest income was mainly the result of increased average transaction volumes during the fiscal year, with basically no change in average interest rates.

***(g) Noninterest Income***

Noninterest income decreased by approximately $462,000, from $1.5 million in fiscal year 2012 to $1.1 million income in 2013. This decrease was mainly due to a decrease in the net realized and unrealized gains on investments of $284,000.

The decrease in the net realized and unrealized gains on investment results from the combined effect of a $257,000 decrease in net unrealized gains of investment securities and a $27,000 decrease in net realized gains from the disposition of investments.

***(h) Provision for Loan Losses***

Compared to 2012, the provision for loan losses shows an increase of $2.2 million. Impaired loans requiring an allowance for losses increased by $7.5 million, from $39.5 million in 2012 to $47 million in 2013, and the specific reserve for these increased by $3.3 million, from $12 million to $15.3 million. As a percentage of the total loans portfolio, impaired loans represent 28% and 28.1% at June 30, 2013 and 2012, respectively. Loans charged off during fiscal year 2013 decreased by $5.9 million when compared to 2012, from $15.4 million in 2012 to $9.5 million in 2013. As a percentage of the total loans portfolio, the allowance for loan losses represents 11.5% at June 30, 2013 and 2012.

Loan collections increased from $113.8 million during fiscal year 2012 to $143.7 million for fiscal year 2013.

***(i) Interest Expense***

Total interest expense decreased by 5.0% or $2.3 million, from $46.4 million in 2012 to $44.1 million in 2013. This decrease in interest expense was the result of decreased average principal balances owed.

***(j) Noninterest Expenses***

Noninterest expenses increased by approximately $1.5 million or 12% during fiscal year 2013. This decrease in noninterest expenses resulted from the net effect of the following:

- Provision for losses on loan guarantees in 2013 was $1,062,000, compared to no expense in 2012. The increase is due to loan guarantees paid under the Loan Guarantee Program created by Law No. 9 of the Commonwealth of Puerto Rico in May 9, 2009. Funds for payment of these guarantees were assigned to the Bank under Executive Order OE-2010-005, recorded as a reserve for possible losses on loan guarantees and reclassified to capital contribution in the statement of revenue, expenses, and changes in net position for the year ended June 30, 2013.

- Provision for foreclosed assets increased 33.3% or $250,000, from $750,000 in 2012 to $1 million in 2013.
- Provision for legal claims reflects a reversal of $250,000 during 2012 that caused a decrease in the reserve for legal claims account for the year. This resulted in the variance when compared to the 2013 balance of this provision, which was $0. The legal reserve reversal relates to one specific claim, which created the contingency for that amount in 2010, and which at June 30, 2012 and 2013 is deemed unwarranted.
- Salaries and employee benefits increased by 1.9% or $170,000, from approximately $8.7 million in 2012 to approximately $8.9 million in 2013. The increase is mainly due to an increase in other employee benefits.
- Occupancy and related expenses (including deprecation) increased by 5.8% or 41,000, from approximately $713,000 in 2012 to approximately $754,000 in 2013.
- Advertising expense decreased by 42.5% or 190,000, from approximately $447,000 in 2012 to approximately $257,000 in 2013. The decrease is mainly due to a decrease in related initiatives during the second half of the year.
- Professional fees decreased by 19.1% or $95,000, from approximately $407,000 in 2012 to approximately $312,000 in 2013. The decrease is mainly due to a decrease in other professional services during 2013, mainly consultants for the Credit area.
- All other noninterest expenses increased by approximately $1,000 as compared to fiscal year 2012.

**Analysis of the Overall Financial Position and Results of Operations**

The average balance of funds available from deposits and the related investments reflect a decrease when comparing 2014 to 2013, mainly due to the maturity of $261.8 million in promissory notes. When compared with fiscal year 2013, time deposits balances from other governmental and financial institutions increased 24.6% or $81.4 million in 2014, providing adequate levels of funding to maintain the Bank's activities. Interest rates during fiscal years 2014 and 2013 remained low.

During the fiscal years 2014 and 2013, $2,270,000 and $3,450,000 were recovered in previously charged-off loans, respectively.

### Discussion of Significant Capital Assets and Long-Term Debt Activity

During fiscal year 2014, approximately, $283,000 in capital assets was acquired and approximately $43,000 was retired. During the same period, $261.8 million in promissory notes matured or amortized, while none were issued. As of year-end, the total promissory notes and other note payable balance was $450.1 million. Additional information about capital assets and long-term debt activity is presented in notes 5 and 9 to the basic financial statements, respectively.

### Contacting the Bank's Financial Management

This financial report is designed to provide a general overview of the Bank's finances for those interested. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Economic Development Bank for Puerto Rico, P.O. Box 2134, San Juan, PR 00922-2134.

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Position – Business-Type Activities

June 30, 2014

| Assets | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|
| Current assets: | | | | |
| Cash and due from banks | $ 6,155,939 | — | — | 6,155,939 |
| Interest-bearing deposits and commercial paper | — | 11,605,775 | (11,605,775) | — |
| Securities purchased under agreements to resell | 55,727,000 | — | — | 55,727,000 |
| Investments | 138,982,584 | — | — | 138,982,584 |
| Loans, net of allowance for loan losses of $11,697,394 | 129,719,826 | — | — | 129,719,826 |
| Accrued interest receivable | 9,309,800 | 903 | (903) | 9,309,800 |
| Due from other fund | 12,489 | — | (12,489) | — |
| | 339,907,638 | 11,606,678 | (11,619,167) | 339,895,149 |
| Noncurrent assets: | | | | |
| Investments | 506,016,578 | 46,309,048 | — | 552,325,626 |
| Loans, net of allowance for loan losses of $22,324,149 | 180,866,685 | — | — | 180,866,685 |
| Other assets | 8,344,709 | — | — | 8,344,709 |
| Capital assets: | | | | |
| Land | 2,735,000 | — | — | 2,735,000 |
| Building and improvements | 11,510,087 | — | — | 11,510,087 |
| Furniture and equipment | 5,017,805 | — | — | 5,017,805 |
| Less accumulated depreciation and amortization | (10,449,474) | — | — | (10,449,474) |
| Total capital assets | 8,813,418 | — | — | 8,813,418 |
| | 704,041,390 | 46,309,048 | — | 750,350,438 |
| Total assets | 1,043,949,028 | 57,915,726 | (11,619,167) | 1,090,245,587 |
| **Liabilities** | | | | |
| Current liabilities: | | | | |
| Time deposits | 423,289,720 | — | (11,605,775) | 411,683,945 |
| Securities sold under agreements to repurchase | 45,690,000 | — | — | 45,690,000 |
| Accrued interest payable | 7,541,707 | — | (903) | 7,540,804 |
| Promissory notes and other note payable | 528,924 | — | — | 528,924 |
| Due to other fund | — | 12,489 | (12,489) | — |
| Other current liabilities | 2,854,936 | (401) | — | 2,854,535 |
| | 479,905,287 | 12,088 | (11,619,167) | 468,298,208 |
| Noncurrent liabilities: | | | | |
| Promissory notes and other note payable | 449,608,684 | — | — | 449,608,684 |
| Other liabilities | 6,341,481 | — | — | 6,341,481 |
| | 455,950,165 | — | — | 455,950,165 |
| Total liabilities | 935,855,452 | 12,088 | (11,619,167) | 924,248,373 |
| **Net Position** | | | | |
| Net investment in capital assets | (109,502) | — | — | (109,502) |
| Restricted for special loan programs | 18,076,756 | — | — | 18,076,756 |
| Unrestricted | 90,126,322 | 57,903,638 | — | 148,029,960 |
| Total net position | $ 108,093,576 | 57,903,638 | — | 165,997,214 |

See accompanying notes to basic financial statements.

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue, Expenses, and Changes in Net Position – Business-Type Activities

Year ended June 30, 2014

| | | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|---|
| Operating revenue: | | | | | |
| Interest income: | | | | | |
| Deposits with other banks and commercial paper | $ | 114,650 | 54,366 | (54,366) | 114,650 |
| Securities purchased under agreements to resell | | 1,067,582 | — | — | 1,067,582 |
| Investments | | 30,361,096 | 4,289,231 | — | 34,650,327 |
| Loans | | 15,292,876 | — | — | 15,292,876 |
| Total interest income | | 46,836,204 | 4,343,597 | (54,366) | 51,125,435 |
| Noninterest income: | | | | | |
| Net realized and unrealized (losses) gains on investments | | (2,238,910) | 4,720,074 | — | 2,481,164 |
| Other income (loss) | | 468,570 | 10,000 | (42,015) | 436,555 |
| Total noninterest (loss) income | | (1,770,340) | 4,730,074 | (42,015) | 2,917,719 |
| Total operating revenue | | 45,065,864 | 9,073,671 | (96,381) | 54,043,154 |
| Operating expenses: | | | | | |
| Provision for loan losses | | 10,960,000 | — | — | 10,960,000 |
| Interest expense: | | | | | |
| Time deposits | | 3,700,831 | — | (54,366) | 3,646,465 |
| Securities sold under agreements to repurchase | | 768,772 | — | — | 768,772 |
| Promissory notes and other note payable | | 21,314,343 | 3,829,428 | — | 25,143,771 |
| Total interest expense | | 25,783,946 | 3,829,428 | (54,366) | 29,559,008 |
| Noninterest expenses: | | | | | |
| Salaries and employee benefits | | 8,525,594 | 27,876 | — | 8,553,470 |
| Depreciation and amortization | | 361,885 | — | — | 361,885 |
| Occupancy and related expenses | | 345,240 | — | — | 345,240 |
| Professional fees | | 361,034 | 62,876 | (42,015) | 381,895 |
| Advertising | | 263,550 | — | — | 263,550 |
| Other | | 2,519,254 | 33 | — | 2,519,287 |
| Total noninterest expenses | | 12,376,557 | 90,785 | (42,015) | 12,425,327 |
| Total operating expenses | | 49,120,503 | 3,920,213 | (96,381) | 52,944,335 |
| Operating (loss) income | | (4,054,639) | 5,153,458 | — | 1,098,819 |
| Capital contribution | | 4,816,018 | — | — | 4,816,018 |
| Increase in net position | | 761,379 | 5,153,458 | — | 5,914,837 |
| Total net position, beginning of year | | 107,332,197 | 52,750,180 | — | 160,082,377 |
| Total net position, end of year | $ | 108,093,576 | 57,903,638 | — | 165,997,214 |

See accompanying notes to basic financial statements.

## ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2014

| | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Cash payments for goods and services | $ (2,614,876) | (62,909) | — | (2,677,785) |
| Cash payments to employees | (8,322,868) | (37,253) | — | (8,360,121) |
| Cash received from interest and principal on loans | 143,960,956 | — | — | 143,960,956 |
| Other (receipts) payments | (366,257) | 34,214 | — | (332,043) |
| Cash disbursed for loaned amounts | (177,479,304) | — | — | (177,479,304) |
| Net cash used in operating activities | (44,822,349) | (65,948) | — | (44,888,297) |
| Cash flows from noncapital financing activities: | | | | |
| Net increase (decrease) in: | | | | |
| Time deposits | 78,791,983 | — | 2,574,268 | 81,366,251 |
| Securities sold under agreements to repurchase | (30,510,000) | — | — | (30,510,000) |
| Repayment of promissory notes | (28,632,932) | (233,200,000) | — | (261,832,932) |
| Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes | (24,275,942) | (4,274,709) | 54,290 | (28,496,361) |
| Net cash (used in) provided by noncapital financing activities | (4,626,891) | (237,474,709) | 2,628,558 | (239,473,042) |
| Cash flows from capital and related financing activities: | | | | |
| Capital contribution | 4,816,018 | — | — | 4,816,018 |
| Acquisition of capital assets | (283,282) | — | — | (283,282) |
| Principal payment on capital debt | (498,985) | — | — | (498,985) |
| Interest paid on capital debt | (565,314) | — | — | (565,314) |
| Net cash provided by capital and related financing activities | 3,468,437 | — | — | 3,468,437 |
| Cash flows from investing activities: | | | | |
| Acquisition of investments | (36,725,000) | (9,264,286) | — | (45,989,286) |
| Proceeds from sales, principal repayments and maturities of investments | 106,886,998 | 239,388,406 | — | 346,275,404 |
| Net decrease (increase) in: | | | | |
| Interest-bearing deposits with other banks | — | 2,574,268 | (2,574,268) | — |
| Securities purchased under agreements to resell | (55,727,000) | — | — | (55,727,000) |
| Interest collected on investments, notes receivable, interest-bearing deposits with other banks, and commercial paper | 31,356,465 | 4,842,269 | (54,290) | 36,144,444 |
| Proceeds from sales of foreclosed assets | 779,097 | — | — | 779,097 |
| Net cash provided by investing activities | 46,570,560 | 237,540,657 | (2,628,558) | 281,482,659 |
| Net increase in cash and due from banks | 589,757 | — | — | 589,757 |
| Cash and due from banks, beginning of year | 5,566,182 | — | — | 5,566,182 |
| Cash and due from banks, end of year | $ 6,155,939 | — | — | 6,155,939 |

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2014

| | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|
| Reconciliation of operating (loss) income to net cash used in operating activities: | | | | |
| Operating (loss) income | $ (4,054,639) | 5,153,458 | — | 1,098,819 |
| Adjustments to reconcile operating (loss) income to net cash used in operating activities: | | | | |
| Depreciation and amortization | 361,885 | — | — | 361,885 |
| Net realized and unrealized loss (gain) on investments | 2,238,910 | (4,672,074) | — | (2,433,164) |
| Provision for loan losses | 10,960,000 | — | — | 10,960,000 |
| Provision for losses on foreclosed assets | 900,000 | — | — | 900,000 |
| Provision for losses on loan guarantees | 16,250 | — | — | 16,250 |
| Loss on sale of foreclosed assets | 172,693 | — | — | 172,693 |
| Interest income from investments | (31,543,328) | (4,343,597) | 54,366 | (35,832,559) |
| Decrease in accrued interest receivable from loans | (340,919) | — | — | (340,919) |
| Interest expense | 25,783,946 | 3,829,428 | (54,366) | 29,559,008 |
| Increase in other assets | (981,315) | (23,787) | — | (1,005,102) |
| Increase in loans receivable | (48,470,304) | — | — | (48,470,304) |
| Decrease (increase) in other liabilities | 134,472 | (9,376) | — | 125,096 |
| Net cash used in operating activities | $ (44,822,349) | (65,948) | — | (44,888,297) |
| Supplemental cash flow information and noncash transactions: | | | | |
| (Decrease) increase in fair value of investments | $ (2,043,999) | 1,672,074 | — | (371,925) |
| Transfer from loans to foreclosed real estate | 696,959 | — | — | 696,959 |
| Retirement of fully depreciated capital assets | 42,705 | — | — | 42,705 |

See accompanying notes to basic financial statements.

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Net Position – Business-Type Activities

June 30, 2013

| **Assets** | | **EDB Operating fund** | **EDB Capital investment** | **Eliminations** | **Total** |
|---|---|---|---|---|---|
| Current assets: | | | | | |
| Cash and due from banks | $ | 5,566,182 | — | — | 5,566,182 |
| Interest-bearing deposits and commercial paper | | — | 14,180,043 | (14,180,043) | — |
| Investments | | 3,722,532 | — | — | 3,722,532 |
| Loans, net of allowance for loan losses of $14,602,633 | | 124,661,901 | — | — | 124,661,901 |
| Accrued interest receivable | | 8,782,017 | 499,575 | (827) | 9,280,765 |
| Due from other fund | | 36,275 | — | (36,275) | — |
| | | 142,768,907 | 14,679,618 | (14,217,145) | 143,231,380 |
| Noncurrent assets: | | | | | |
| Investments | | 713,677,538 | 271,761,094 | — | 985,438,632 |
| Loans, net of allowance for loan losses of $21,131,540 | | 149,111,265 | — | — | 149,111,265 |
| Other assets | | 8,494,440 | — | — | 8,494,440 |
| Capital assets: | | | | | |
| Land | | 2,735,000 | — | — | 2,735,000 |
| Building and improvements | | 11,340,844 | — | — | 11,340,844 |
| Furniture and equipment | | 4,946,471 | — | — | 4,946,471 |
| Less accumulated depreciation and amortization | | (10,130,294) | — | — | (10,130,294) |
| Total capital assets | | 8,892,021 | — | — | 8,892,021 |
| | | 880,175,264 | 271,761,094 | — | 1,151,936,358 |
| Total assets | | 1,022,944,171 | 286,440,712 | (14,217,145) | 1,295,167,738 |
| **Liabilities** | | | | | |
| Current liabilities: | | | | | |
| Time deposits | | 344,497,737 | — | (14,180,043) | 330,317,694 |
| Securities sold under agreements to repurchase | | 76,200,000 | — | — | 76,200,000 |
| Accrued interest payable | | 6,599,017 | 445,282 | (827) | 7,043,472 |
| Promissory notes and other note payable | | 498,985 | — | — | 498,985 |
| Due to other fund | | — | 36,275 | (36,275) | — |
| Other current liabilities | | 2,727,871 | 3,895 | — | 2,731,766 |
| | | 430,523,610 | 485,452 | (14,217,145) | 416,791,917 |
| Noncurrent liabilities: | | | | | |
| Promissory notes and other note payable | | 478,770,540 | 233,200,000 | — | 711,970,540 |
| Other liabilities | | 6,317,824 | 5,080 | — | 6,322,904 |
| | | 485,088,364 | 233,205,080 | — | 718,293,444 |
| Total liabilities | | 915,611,974 | 233,690,532 | (14,217,145) | 1,135,085,361 |
| **Net Position** | | | | | |
| Net investment in capital assets | | (529,884) | — | — | (529,884) |
| Restricted for special loan programs | | 13,259,414 | — | — | 13,259,414 |
| Unrestricted | | 94,602,667 | 52,750,180 | — | 147,352,847 |
| Total net position | $ | 107,332,197 | 52,750,180 | — | 160,082,377 |

See accompanying notes to basic financial statements.

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Revenue, Expenses, and Changes in Net Position – Business-Type Activities

Year ended June 30, 2013

| | | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|---|
| Operating revenue: | | | | | |
| Interest income: | | | | | |
| Deposits with other banks and commercial paper | $ | 981,522 | 44,977 | (44,977) | 981,522 |
| Securities purchased under agreements to resell | | 1,817,891 | — | — | 1,817,891 |
| Investments | | 31,455,334 | 19,307,033 | — | 50,762,367 |
| Loans | | 14,268,058 | — | — | 14,268,058 |
| Total interest income | | 48,522,805 | 19,352,010 | (44,977) | 67,829,838 |
| Noninterest income: | | | | | |
| Net realized and unrealized (losses) gains on investments | | (2,818,902) | 3,181,669 | — | 362,767 |
| Other income | | 755,793 | — | (43,623) | 712,170 |
| Total noninterest (loss) income | | (2,063,109) | 3,181,669 | (43,623) | 1,074,937 |
| Total operating revenue | | 46,459,696 | 22,533,679 | (88,600) | 68,904,775 |
| Operating expenses: | | | | | |
| Provision for loan losses | | 10,788,145 | — | — | 10,788,145 |
| Interest expense: | | | | | |
| Time deposits | | 3,606,511 | — | (44,977) | 3,561,534 |
| Securities sold under agreements to repurchase | | 1,649,528 | — | — | 1,649,528 |
| Promissory notes and other note payable | | 21,636,967 | 17,253,971 | — | 38,890,938 |
| Total interest expense | | 26,893,006 | 17,253,971 | (44,977) | 44,102,000 |
| Noninterest expenses: | | | | | |
| Salaries and employee benefits | | 8,776,633 | 95,621 | — | 8,872,254 |
| Depreciation and amortization | | 392,795 | — | — | 392,795 |
| Occupancy and related expenses | | 361,115 | — | — | 361,115 |
| Professional fees | | 311,576 | 43,623 | (43,623) | 311,576 |
| Advertising | | 257,023 | 151 | — | 257,174 |
| Other | | 3,707,917 | 510 | — | 3,708,427 |
| Total noninterest expenses | | 13,807,059 | 139,905 | (43,623) | 13,903,341 |
| Total operating expenses | | 51,488,210 | 17,393,876 | (88,600) | 68,793,486 |
| Operating (loss) income | | (5,028,514) | 5,139,803 | — | 111,289 |
| Capital contribution | | 2,457,725 | — | — | 2,457,725 |
| (Decrease) increase in net position | | (2,570,789) | 5,139,803 | — | 2,569,014 |
| Total net position, beginning of year | | 109,902,986 | 47,610,377 | — | 157,513,363 |
| Total net position, end of year | $ | 107,332,197 | 52,750,180 | — | 160,082,377 |

See accompanying notes to basic financial statements.

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2013

| | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|
| Cash flows from operating activities: | | | | |
| Cash payments for goods and services | $ (2,909,260) | (44,284) | — | (2,953,544) |
| Cash payments to employees | (8,944,840) | (101,593) | — | (9,046,433) |
| Cash received from interest and principal on loans | 155,995,662 | — | — | 155,995,662 |
| Other (receipts) payments | (915,411) | 88,683 | — | (826,728) |
| Cash disbursed for loaned amounts | (191,934,875) | — | — | (191,934,875) |
| Net cash used in operating activities | (48,708,724) | (57,194) | — | (48,765,918) |
| Cash flows from noncapital financing activities: | | | | |
| Net increase (decrease) in: | | | | |
| Time deposits | (211,158,117) | — | (2,138,152) | (213,296,269) |
| Securities sold under agreements to repurchase | (47,725,000) | — | — | (47,725,000) |
| Issuance of promissory notes | 150,003,356 | — | — | 150,003,356 |
| Repayment of promissory notes | (131,296,574) | (41,800,000) | — | (173,096,574) |
| Interest paid on time deposits, securities sold under agreements to repurchase, and promissory notes | (26,085,129) | (17,325,960) | 44,735 | (43,366,354) |
| Net cash used in noncapital financing activities | (266,261,464) | (59,125,960) | (2,093,417) | (327,480,841) |
| Cash flows from capital and related financing activities: | | | | |
| Capital contribution | 2,457,725 | — | — | 2,457,725 |
| Acquisition of capital assets | (101,975) | — | — | (101,975) |
| Principal payment on capital debt | (470,741) | — | — | (470,741) |
| Interest paid on capital debt | (593,559) | — | — | (593,559) |
| Net cash provided by capital and related financing activities | 1,291,450 | — | — | 1,291,450 |
| Cash flows from investing activities: | | | | |
| Acquisition of investments | (208,246,527) | — | — | (208,246,527) |
| Principal repayments and maturities of investments | 302,707,579 | 41,890,001 | — | 344,597,580 |
| Net decrease (increase) in: | | | | |
| Interest-bearing deposits with other banks | 121,500,000 | (2,138,152) | 2,138,152 | 121,500,000 |
| Securities purchased under agreements to resell | 62,251,000 | — | — | 62,251,000 |
| Interest collected on investments, notes receivable, interest-bearing deposits with other banks, and commercial paper | 34,531,629 | 19,431,305 | (44,735) | 53,918,199 |
| Proceeds from sales of foreclosed assets | 1,021,250 | — | — | 1,021,250 |
| Net cash provided by investing activities | 313,764,931 | 59,183,154 | 2,093,417 | 375,041,502 |
| Net increase in cash and due from banks | 86,193 | — | — | 86,193 |
| Cash and due from banks, beginning of year | 5,479,989 | — | — | 5,479,989 |
| Cash and due from banks, end of year | $ 5,566,182 | — | — | 5,566,182 |

**ECONOMIC DEVELOPMENT BANK FOR PUERTO RICO**
(A Component Unit of the Commonwealth of Puerto Rico)

Statement of Cash Flows – Business-Type Activities

Year ended June 30, 2013

| | EDB Operating fund | EDB Capital investment | Eliminations | Total |
|---|---|---|---|---|
| Reconciliation of operating (loss) income to net cash used in operating activities: | | | | |
| Operating (loss) income | $ (5,028,514) | 5,139,803 | — | 111,289 |
| Adjustments to reconcile operating (loss) income to net cash used in operating activities: | | | | |
| Depreciation and amortization | 392,795 | — | — | 392,795 |
| Net realized and unrealized loss (gain) on investments | 2,818,902 | (3,129,919) | — | (311,017) |
| Provision for loan losses | 10,788,145 | — | — | 10,788,145 |
| Provision for losses on foreclosed assets | 1,000,000 | — | — | 1,000,000 |
| Provision for losses on loan guarantees | 1,061,855 | — | — | 1,061,855 |
| Gain on sale of foreclosed assets | (12,750) | — | — | (12,750) |
| Interest income from investments | (34,254,747) | (19,352,011) | 44,977 | (53,561,781) |
| Decrease in accrued interest receivable from loans | (279,578) | — | — | (279,578) |
| Interest expense | 26,893,006 | 17,253,971 | (44,977) | 44,102,000 |
| (Increase) decrease in other assets | (117,835) | 36,933 | — | (80,902) |
| Increase in loans receivable | (49,927,693) | — | — | (49,927,693) |
| (Increase) decrease in other liabilities | (2,042,310) | (5,971) | — | (2,048,281) |
| Net cash used in operating activities | $ (48,708,724) | (57,194) | — | (48,765,918) |
| Supplemental cash flow information and noncash transactions: | | | | |
| (Decrease) increase in fair value of investments | $ (2,607,444) | 3,129,919 | — | 522,475 |
| Transfer from loans to foreclosed real estate | 3,977,167 | — | — | 3,977,167 |
| Retirement of fully depreciated capital assets | 29,452 | — | — | 29,452 |

See accompanying notes to basic financial statements.

## (1) Organization and Summary of Significant Accounting Policies

Economic Development Bank for Puerto Rico (the Bank) was created by the Puerto Rico Development Bank Act No. 22 of July 24, 1985, as amended, and constitutes a public corporation of the Commonwealth of Puerto Rico (the Commonwealth). The Bank is a component unit included in the Commonwealth's financial reporting entity and is a separate legal entity. The Bank promotes the development of the private sector of the economy of Puerto Rico. This is accomplished by making direct loans, loan guarantees, loan participations, and/or direct investments available to any person or business organization devoted to manufacturing, agriculture, trade, tourism, or other service enterprises, whose economic activity may have the effect of substituting imports, without this being understood as a limitation.

The Bank's operation consists principally in granting commercial loans and capital investments to small businesses, receiving deposits from other governmental or commercial financial institutions, issuing notes and other debts, and investing in securities and other financial instruments, similar to a private commercial bank. All revenue, such as interest, gains, dividends, and fees related to these activities, are presented as operating income. All expenses related to these revenue activities, such as interest expense, provision for losses, and administrative expenses, are considered operating expenses. For financial statements presentation, operating revenue is segregated between interest income and noninterest income, and operating expenses between interest expense, provision for losses, and other noninterest expenses.

The Bank is not required to pay any taxes on any assets acquired or to be acquired for its operations or activities, or on the revenue received from any of its operations or activities.

In 2006, the Bank's board of directors created a component unit named Economic Development Bank Capital Investment (EDBCI). EDBCI is a blended component unit of the Bank, which is presented as a business-type activity. The balances and transactions of EDBCI have been blended with the Bank in accordance with U.S. generally accepted accounting principles (GAAP) because, though legally separated, it was created and can be dissolved through resolutions of the Bank's board of directors. The board of directors of EDBCI is the same as that of the Bank. EDBCI operation consists only of supporting the Bank's mission in promoting the development of the private sector of the economy of Puerto Rico, investing in equity and other forms of capital of start-up, early, or later stage local enterprises or venture capital funds. During fiscal year 2007, the Bank transferred its capital investment portfolio, amounting to \$27,445,966, as initial capital to EDBCI. An additional \$30 million was approved for new capital investments as deemed necessary in EDBCI investment activity. Also, EDBCI was authorized to invest in corporate paper as part of a new notes payable program like the one described in note 9.

The accounting policies followed by the Bank are in accordance with GAAP, as applicable to governmental entities. The business-type activities of the Bank are accounted for as an enterprise fund. Accordingly, the Bank follows the accrual basis of accounting and the economic resources measurement focus. Revenue is recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid. The following is a description of the most significant accounting policies:

### *(a) Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates made by management include the allowance for loan losses, losses on foreclosed assets, losses on loan guarantees, and venture capital investments; the useful lives of fixed assets; the valuation of fixed assets and investments; and accruals for legal claims and other contingencies. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions.

### *(b) Basis of Presentation*

The basic financial statements are presented on the accrual basis of accounting.

### *(c) Securities Purchased under Agreements to Resell*

The Bank enters into purchases of securities under agreements to resell, as authorized by Act number 22 of July 24, 1985, Article 3. The amounts advanced under these agreements are reflected as an asset in the accompanying statements of net position. The securities underlying these agreements, mainly interest-bearing deposits with other banks and government securities, are held under safekeeping by a financial institution independent of the transaction.

### *(d) Investments*

The Bank follows GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This Statement establishes accounting and financial reporting standards for all investments held by governmental external investment pools. For most other governmental entities, it requires that most investments be reported at fair value in the statements of net position.

The governing board authorizes the Bank to invest in the following:

- U.S. government and agencies obligations
- Obligations of the Commonwealth, its agencies, municipalities, public corporations, and instrumentalities
- Certificates and time deposits

- Commercial paper
- Bankers' acceptance
- Federal funds
- Securities purchased under agreements to resell
- Mortgage- and asset-backed securities
- Corporate notes
- External investment pools

The Bank's investment policies also establish limitations and other guidelines on amounts to be invested in the aforementioned investment categories. Such policies provide the requirements in the institutions with which investment transactions can be entered into. In addition to the Assets, Liabilities, and Investments Committee (ALCO), the Board of Directors of the Bank may approve, as necessary, other transactions that the Bank may enter into.

Investments in debt securities are presented at fair value, including the effect of applicable put options as described in note 9. Money market investments and participating interest-earning investment contracts with a remaining maturity at time of purchase of one year or less are presented at amortized cost. Changes in the fair value of investments are presented in net realized and unrealized gains (losses) on investments in the statements of revenue, expenses, and changes in net position. Fair value is determined based on quoted market prices.

Investments also include common and preferred stocks of various local enterprises that do not have readily determinable fair value and investment positions in external investment pools. The investments in common and preferred stocks are temporary and the Bank generally does not have the ability to exercise significant influence over the investees' operating and financial policies, and therefore, such investments are carried at the lower of cost or net realizable value based on management's evaluation of the financial condition of each investee. Because of uncertainties inherent in the estimation process, management's evaluation of the financial condition of the investees, and the related assessment of net realizable value may change in the near term.

Investment positions in external investment pools are reported at the net asset value of the shares held by the Bank. Such net asset value represents the fair value per share of the pools' underlying net assets. The financial statements of these pools include securities whose fair values have been estimated by the pools' managers in the absence of readily ascertainable market values. The Bank's external investment pools that are not registered with the Securities and Exchange Commission are supervised by the Commissioner of Financial Institutions, which is the governmental agency that regulates venture capital funds and the banking industry in Puerto Rico.


(Continued)

### *(e) Loans*

Loans are presented at the unpaid principal balance reduced by the allowance for loan losses, and any deferred fees or costs on originated loans. In accordance with the Bank's charge-off policy unsecured loans are charged off against the allowance for loans losses within 60 days after they have payments due over 120 days. For collateralized loans, charge-offs are recognized for the amount of collateral deficiency within 60 days after they have payments due over 180 days. Although one of the factors evaluated by management in making this assessment is the number of days past due, the policy also allows the Bank to charge-off loans when special circumstances arise and upon the approval of the corresponding level of authority.

Recoveries of loans previously charged off are credited to the allowance for loan losses.

The accrual of interest on loans ceases when loans become past due 90 days or more and/or on those loans undergoing judicial or bankruptcy proceedings. Once a loan is placed on nonaccrual status, all accrued but uncollected interest is reversed from interest income. Interest on all nonaccrual loans is thereafter included in earnings only to the extent actually collected. Loans designated as nonaccruing are not returned to an accrual status until interest is received on a current basis and those factors indicative of doubtful collection cease to exist.

Collections received for nonaccrual loans are applied, for financial statement purposes, to principal owed. The change in payment application for nonaccrual loans is intended to reduce the recorded exposure to losses as well as the related required levels of the allowance for losses. Delinquency history and collection efforts are monitored in accordance with the full accrual amortization schedule of the loan.

The allowance for loan losses is maintained at a level believed adequate by management to absorb potential losses in the loan portfolio. Management's determination of the adequacy of the allowance is based on an evaluation of the portfolio, past loan loss experience, economic conditions, volume growth, composition of the loan portfolio, and other relevant factors. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. Changes in the allowance relating to impaired loans are charged or credited to the provision for loan losses. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio, and the related allowance may change in the near term.

### *(f) Classification of Loans and Allowance for Loan Losses*

The current portion of loans includes the active principal of loans with maturities of one year or less and past due over three months and/or those loans undergoing judicial or bankruptcy proceedings. Also, these include the estimated current portion of loans with maturity over one year. The resulting difference was reported as the noncurrent portion.

The allowance for loan losses was allocated between current and noncurrent proportionally based on the loan classification.

***(g) Loan Guarantee Program***

Guarantee fees on the loan guarantee program are recognized as income when the fees are collected. Such fees are estimated not to exceed related guarantee expenses. The accrual for losses on loan guarantees is based on management's evaluation of the potential loss on each guarantee, net of amounts recoverable from collateral and the share of loss of the participating banks, and is included in other liabilities. Because of uncertainties inherent in the estimation process, management's estimate of the provision for losses on loan guarantees, and the related accrual for losses on loan guarantees may change in the near term.

***(h) Loan Origination Costs and Commitment Fees***

In accordance with GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, the Bank records fees related to loan origination and commitment as revenue in the period received. Direct loan origination costs are recognized as expense in the period incurred.

***(i) Real Estate Owned***

Real estate owned acquired in satisfaction of loans is included in other assets and is held for sale. Properties acquired through foreclosure are transferred to real estate owned and recognized at the lower of fair value minus estimated costs to sell or the loan's carrying value, establishing a new cost basis. Subsequent declines in the value of real estate owned are provided for when it is probable the cost will not be recovered and that a loss will be incurred. An allowance for losses on real estate owned is maintained for subsequent valuation adjustments on a specific property basis.

***(j) Capital Assets***

Capital assets are defined by the Bank as assets with an individual initial cost of over $500 and expected useful lives of over one year. Capital assets are stated at cost, less accumulated depreciation and amortization. Depreciation is computed on the straight-line basis over the estimated useful lives of the depreciable assets, which have been determined to be 3 years for computer software, 5 years for all furniture and equipment, and 40 years for building and improvements. Expenditures for major improvements that extend the useful life of the asset are capitalized. Maintenance and repairs are charged to expense.

***(k) Securities Sold under Agreements to Repurchase***

The Bank enters into sales of securities under agreements to repurchase, as authorized by Act number 22 of July 24, 1985, Article 3. These agreements are presented as a liability in the accompanying statements of net position. The securities underlying these agreements are usually held by the broker or its agent, with whom the agreement is transacted.

***(l) Accounting for Compensated Absences***

Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay or salary rates in effect at the statement of net position date. An additional amount is accrued for certain salary related benefits associated with the payment of compensated absences. Such amounts are included in other liabilities and the accompanying financial statements.


(Continued)

***(m) Statements of Cash Flows***

The accompanying statements of cash flows are presented in accordance with the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. For purposes of reporting cash flows, cash includes cash on hand, amounts due from banks, and items in process of collection.

***(n) Adoption of New Accounting Pronouncements***

During the fiscal year ended June 30, 2014, the Bank adopted the following new accounting standards issued by the GASB:

(i) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or vice versa. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The implementation of GASB Statement No. 65 had no impact in the accompanying financial statements.

(ii) GASB Statement No. 66, *Technical Corrections* 2012. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre – November 30, 1989 FASB and AICPA Pronouncements*. This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The implementation of GASB Statement No. 66 had no impact in the accompanying financial statements.

(iii) GASB Statement No. 67, *Financial Reporting for Pension Plans* – an amendment of GASB Statement No. 25. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The implementation of GASB Statement No. 67 had no impact in the accompanying financial statements.

(iv) GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local governments that extend and receive nonexchange financial guarantees. This Statement requires a governmental entity guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. The implementation of GASB Statement No 70 had no impact in the accompanying financial statements.

***(o) Future Adoption of Accounting Pronouncements***

The GASB has issued the following accounting standards that have effective dates after June 30, 2014, and are expected to impact the Bank:

(i) GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* – an amendment of GASB Statement No. 27. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014. The effects of adopting this standards have not been determined but are expected to result in the recognition of a significant unfunded pension obligation.

(ii) GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement* Date – *an amendment* of GASB *Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined-benefit pension plan after the measurement date of the government’s beginning net pension liability. This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.

## (2) Cash and Due from Banks, Interest-Bearing Deposits with Other Banks and Commercial Paper, and Securities Purchased under Agreements to Resell

As of June 30, 2014 and 2013, the carrying amount and the corresponding depository bank balances of cash and due from banks and interest-bearing deposits with other banks were as follows:

| | | 2014 | |
|---|---|---|---|
| | | Carrying amount | Depository bank balance |
| Cash and due from banks | $ | 6,155,939 | 8,288,724 |

| | | 2013 | |
|---|---|---|---|
| | | Carrying amount | Depository bank balance |
| Cash and due from banks | $ | 5,566,182 | 7,023,956 |

As of June 30, 2014 and 2013, the total depository bank balance consisted of $4,061,657 and $4,794,649, respectively, which was insured or collateralized with securities held by the Department of the Treasury of the Commonwealth and $4,227,067 and $2,229,307, respectively, deposited with the Government Development Bank for Puerto Rico (GDB), another component unit of the Commonwealth. Deposits with GDB are uninsured and uncollateralized.

The Bank’s investment policies allow management to purchase commercial paper. The following table summarizes certain information about these purchases for the year ended June 30, 2014 and 2013:

| | | 2014 | 2013 |
|---|---|---|---|
| Carrying amount at June 30 | $ | — | — |
| Average amount outstanding during the year | | 1,444,238 | 4,837,000 |
| Maximum amount outstanding at any month-end | | — | — |
| Weighted average interest rate for the year | | 0.41% | 0.30% |

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to purchase securities under agreements to resell. The following table summarizes certain information about these agreements:

| | | 2014 | 2013 |
|---|---|---|---|
| Carrying amount at June 30 | $ | 55,727,000 | — |
| Average amount outstanding during the year | | 102,225,000 | 191,751,000 |
| Maximum amount outstanding at any month-end | | 166,947,000 | 302,225,000 |
| Weighted average interest rate for the year | | 1.17% | 0.91% |
| Weighted average interest rate at year-end | | 1.25 | — |
| Weighted average maturity (years) | | 0.06 | — |

The Bank's investment policies establish the minimum amount of acceptable collateral. The market prices of the collateral are revised monthly and the margin amount adjusted accordingly. The aggregate market value of the securities underlying the agreements outstanding at June 30, 2014 and 2013 was $82,015,000 and $0, respectively.

## (3) Investments

As of June 30, 2014 and 2013, the Bank had the following investments:

| | | June 30, 2014 | |
|---|---|---|---|
| **Investment type** | | **Fair value** | **Weighted average maturity (years)** |
| Federal Home Loan Bank – MBS | $ | 676,865 | 1.0 |
| Federal National Mortgage Association – MBS – notes payable program | | 150,000,000 | See below |
| Municipal bonds | | 148,481,732 | 0.5 |
| Municipal bonds – notes payable program | | 267,331,170 | See below |
| Collateralized mortgage obligations (residential) | | 53,575,714 | 2.3 |
| Collateralized mortgage obligations – notes payable program (residential) | | 23,933,681 | See below |
| External investment pools | | 36,186,412 | N/A |
| Equity investments | | 11,122,636 | N/A |
| Total fair value | $ | 691,308,210 | |

| | June 30, 2013 | |
|---|---|---|
| **Investment type** | **Fair value** | **Weighted average maturity (years)** |
| Federal Home Loan Bank – MBS | $ 1,116,082 | 0.6 |
| Federal National Mortgage Association – MBS – notes payable program | 150,000,000 | See below |
| Municipal bonds | 150,134,600 | 1.6 |
| Municipal bonds – notes payable program | 267,830,978 | See below |
| Corporate paper – notes payable program | 233,200,000 | See below |
| Collateralized mortgage obligations (residential) | 96,250,284 | 2.7 |
| Collateralized mortgage obligations – notes payable program (residential) | 52,068,126 | See below |
| External investment pools | 36,738,457 | N/A |
| Equity investments | 1,822,637 | N/A |
| Total fair value | $ 989,161,164 | |

*Interest rate risk* – In accordance with its investment policy, the Bank manages its exposure to declines in fair values by limiting the weighted average maturity of its investment portfolio generally to less than three years.

Those investments related to the notes payable programs involve matched transactions that generate a fixed spread of income to the Bank. These were directly approved by the Bank's board of directors and are not subject to the maximum maturity policy. As of June 30, 2014 and 2013, the investments, which serve as collateral to the notes payable program have a weighted average maturity of 11.2 and 9.9 years, respectively.

In addition, investments in external investment pools and equity securities are not subject to the maximum maturity policy since they do not carry a maturity date. These instruments are not sold on secondary markets and are not priced in any stock exchange, and as such, its fair value depends on the performance of the involved enterprises. The inherent risk in these investments is managed through credit analysis, periodic reviews of results of operations, and meetings with subject companies and investment pools managers.

*Credit risk* – The Bank's investment policy limits long-term investment 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.

As of June 30, 2014, the Bank's investments in collateralized mortgage obligations were rated AAA or AA+ by Standard & Poor's, Aaa, A3, Baa1, or Caa3 by Moody's Investor Service and AAA or D by Fitch Ratings; the Bank's investment in Federal National Mortgage Association and Federal Home Loan Bank were rated AA+ by Standard & Poor's, Aaa by Moody's Investor Service and AAA by Fitch Ratings; and the Bank's investment in municipal bonds were rated AAA, AA-, A+, BB+, or BB by Standard & Poor's and Aaa, Aa1, Aa3, A1, A2, Baa3, Ba2, B1, B2, or B3 by Moody's Investor Service.

As of June 30, 2013, the Bank's investments in corporate paper were rated B+ by Standard & Poor's and B1 by Moody's Investor Service; the Bank's investments in collateralized mortgage obligations were rated AAA, AA+, A+, BBB+, BB+, or D by Standard & Poor's and AAA, BBB, or D by Fitch Ratings; the Bank's investment in Federal National Mortgage Association, and Federal Home Loan Bank were rated AA+ by Standard & Poor's, Aaa by Moody's Investor Service and AAA by Fitch Ratings; and the Bank's investment in municipal bonds were rated AAA, AA-, or BBB- by Standard & Poor's and Aaa, Aa1, Aa3, A1, A2, or Baa3 by Moody's Investor Service.

| | Credit Risk | | | |
|---|---|---|---|---|
| | Rating [1] | | | |
| Securities type | AAA to BBB | BB to D | NR | Total |
| Federal Home Loan Bank – MBS | $ 676,865 | — | — | 676,865 |
| Federal National Mortgage Association – MBS – notes payable program | 150,000,000 | — | — | 150,000,000 |
| Municipal bonds | — | 148,481,732 | — | 148,481,732 |
| Municipal bonds – notes payable program | 267,331,170 | — | — | 267,331,170 |
| Collateralized mortgage obligations (residential) | 52,279,524 | 1,296,190 | — | 53,575,714 |
| Collateralized mortgage obligations - notes payable program (residential) | 23,933,681 | — | — | 23,933,681 |
| External investment pools | — | — | 36,186,412 | 36,186,412 |
| Equity investments | — | — | 11,122,636 | 11,122,636 |
| | $ 494,221,240 | 149,777,922 | 47,309,048 | 691,308,210 |

[1] Rating obtained from Standard & Poor's or equivalent rating by Moody's Investor Service or Fitch Ratings.

The Bank, through EDBCI, also invests in venture capital through external investment pools and through direct investment in equity securities. The Bank's investments in external investment pools and equity securities are not rated by a nationally recognized statistical rating organization. The related credit risk is measured through credit analysis, periodic reviews of results of operations, and meetings with subject companies' management. In addition, a reserve for possible losses in venture capital investments is recorded as a measure of providing a fair value in the financial statements. As of June 30, 2014 and 2013, the venture capital balances comprised the following:

| | | 2014 | 2013 |
|---|---|---|---|
| External investment pools | $ | 36,186,412 | 36,738,457 |
| Equity investments | | 15,754,000 | 6,204,000 |
| | | 51,940,412 | 42,942,457 |
| Allowance for losses in venture capital investments | | (4,631,364) | (4,381,363) |
| Fair value of venture capital investments | $ | 47,309,048 | 38,561,094 |

The investment strategy of the external investment pools is to seek companies in or outside Puerto Rico that require capital growth or seed capital; although the investment recipients must have operations in Puerto Rico. The current investments in external equity investment pools are in different investment stages of their life cycle. Some of the funds continue evaluating new investment alternatives and others are in its sell-off stage.

In accordance with the partnership agreements for each of the external investment pools, the Bank's investments can only be redeemed upon distribution from funds managers; usually in the form of a sale of its holdings or dividends distributed. The assets held by the funds in sell-off stage should be liquidated within the next three years; whereas the assets held by investment stage funds will take from seven to ten years for liquidation, as expected per its respective partnership agreements. As of June 30, 2014, the Bank does not intend to sell or redeem investments in any external investment pool for an amount different to that presented in the financial statements.

*Custodial credit risk* – Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to the transaction, the Bank may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2014 and 2013, securities investments were registered in the name of the Bank and were held in the possession of the Bank's custodian institution.

The Bank was exposed to the following custodial credit risk for investments held at June 30, 2014:

| | | 2014 | 2013 |
|---|---|---|---|
| Uninsured and registered, with securities held by the counterparty's trust department or agent in the Bank's name | $ | 643,999,162 | 950,600,070 |
| Uninsured and unregistered, with securities held by the Bank | | 47,309,048 | 38,561,094 |
| Total | $ | 691,308,210 | 989,161,164 |

*Concentration of credit risk* – The Bank places no limit on the amount it may invest in any one issuer as a percentage of the investment portfolio. As of June 30, 2014, more than 5% of the Bank's investments are in Municipal Bonds (60.2%) and Federal National Mortgage Association CMO's (23.2%). As of June 30, 2013, more than 5% of the Bank's investments are in Municipal Bonds (42.3%), Popular Inc. (the Issuer) corporate notes (23.6%), and Federal National Mortgage Association CMO's (16.6%).

Proceeds from sales, principal payments, and maturities of investments, including equity investments and gross realized gains or losses, for the years ended June 30, 2014 and 2013 are as follows:

| | | 2014 | 2013 |
|---|---|---|---|
| Proceeds from sales | $ | 15,175,087 | — |
| Proceeds from principal payments and maturities | | 331,100,317 | 344,597,580 |
| Gross gains | | 3,273,354 | — |

## (4) Loans and Allowance for Loan Losses

The balance of current and noncurrent loans consists of loans originated by the Bank and amounts paid under the loan guarantee program. During the years ended June 30, 2014 and 2013, the Bank has made no payments under the loan guarantee program.

Loans distribution among industry sectors as of June 30, 2014 and 2013 are as follows:

| | | 2014 | 2013 |
|---|---|---|---|
| Agricultural | $ | 32,079,461 | 33,621,468 |
| Commercial | | 84,225,635 | 75,635,293 |
| Services | | 157,473,817 | 137,827,358 |
| Manufacturing | | 40,587,740 | 30,095,605 |
| Tourism | | 30,241,401 | 32,327,615 |
| Total loans | | 344,608,054 | 309,507,339 |
| Allowance for loan losses | | (34,021,543) | (35,734,173) |
| | $ | 310,586,511 | 273,773,166 |

The Bank has defined impaired loans as all loans with interest and/or principal past due 90 days or more and other loans for which, based on current information, it is probable that the debtor will be unable to pay according to the contractual terms of the loan agreement. The Bank generally measures impairment based upon the present value of a loan's expected future cash flows, except where foreclosure or liquidation is probable or when the primary source of repayment is provided by collateral. In these circumstances, impairment is measured based upon the fair value of the collateral less estimated selling and disposal costs. The present value of a loan's expected future cash flows is calculated using the loan's effective interest rate based on the original contractual terms.

Cash payments received on impaired loans are recorded in accordance with the contractual terms of the loan. The principal portion of the payments is used to reduce the principal balance of the loan; the interest portion is recognized as interest income. When management believes that collectibility of principal is doubtful, the interest portion may be applied to principal.

At June 30, 2014 and 2013, loan receivables delinquency by industry sector was a follows:

| | 2014 | | | | |
|---|---|---|---|---|---|
| | 0–29 Days | 30–59 Days | 60–89 Days | 90+ Days | Balance outstanding |
| Agricultural | $ 18,418,065 | 763,077 | 937,719 | 11,960,600 | 32,079,461 |
| Commercial | 64,335,515 | 4,877,180 | 384,144 | 14,628,796 | 84,225,635 |
| Services | 138,274,198 | 4,364,710 | 1,230,549 | 13,604,360 | 157,473,817 |
| Manufacturing | 32,796,620 | 411,772 | 16,604 | 7,362,744 | 40,587,740 |
| Tourism | 26,367,347 | — | — | 3,874,054 | 30,241,401 |
| | $ 280,191,745 | 10,416,739 | 2,569,016 | 51,430,554 | 344,608,054 |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | 0–29 Days | 30–59 Days | 60–89 Days | 90+ Days | Balance outstanding |
| Agricultural | $ 21,135,405 | 708,651 | 327,739 | 11,449,673 | 33,621,468 |
| Commercial | 63,992,749 | 2,177,518 | 466,988 | 8,998,038 | 75,635,293 |
| Services | 121,938,074 | 4,996,085 | 2,761,624 | 8,131,575 | 137,827,358 |
| Manufacturing | 25,915,608 | 192,170 | 82,770 | 3,905,057 | 30,095,605 |
| Tourism | 28,142,300 | 245,515 | — | 3,939,800 | 32,327,615 |
| | $ 261,124,136 | 8,319,939 | 3,639,121 | 36,424,143 | 309,507,339 |

The following is a summary of information on loans considered to be impaired in accordance with ASC subtopic 310-35-35 *Receivables*, previously, FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, as of June 30, 2014 and 2013 and the related interest income for the years then ended:

| | | 2014 | 2013 |
|---|---|---|---|
| Recorded investment in impaired loans not requiring an allowance for loan losses | $ | 54,470,000 | 39,750,000 |
| Recorded investment in impaired loans requiring an allowance for loan losses | | 42,285,000 | 47,007,000 |
| Total recorded investment in impaired loans | $ | 96,755,000 | 86,757,000 |
| Related valuation allowance | $ | 13,637,000 | 15,337,000 |
| Average recorded investment in impaired loans | | 86,500,000 | 80,300,000 |
| Interest income recognized | | 1,007,000 | 579,000 |

At June 30, 2014 and 2013, loans on which the accrual of interest has been discontinued (cash basis loans), due to delinquency over 89 days and/or due to restructurings, amounted to $131,420,175 ($51,371,855 over 89 days and $71,384,566 restructured loans) and $105,311,122 ($36,357,648 over 89 days and $80,048,320 restructured loans), respectively. The additional interest income that would have been recorded if these loans had performed in accordance with their original terms is estimated at approximately $9,810,000 and $7,820,000 for the years ended June 30, 2014 and 2013, respectively.

The balance of nonaccrual loans by industry sector at June 30, 2014 and 2013 were as follows:

| | | 2014 | 2013 |
|---|---|---|---|
| Agricultural | $ | 20,201,902 | 19,871,261 |
| Commercial | | 33,446,678 | 23,603,220 |
| Services | | 45,644,723 | 39,152,741 |
| Manufacturing | | 19,043,361 | 7,587,986 |
| Tourism | | 13,083,511 | 15,095,914 |
| | $ | 131,420,175 | 105,311,122 |

The balance of loans classified as troubled debt restructured by industry sector and the related effect in the allowance for loan losses at June 30, 2014 and 2013 is as follows:

| | | 2014 | |
|---|---|---|---|
| | | **Principal** | **Allowance** |
| Agricultural | $ | 21,548,733 | 2,202,794 |
| Commercial | | 21,264,379 | 5,889,212 |
| Services | | 35,769,369 | 4,847,679 |
| Manufacturing | | 8,019,210 | 1,064,635 |
| Tourism | | 10,458,808 | 333,521 |
| | $ | 97,060,499 | 14,337,841 |

| | | 2013 | |
|---|---|---|---|
| | | **Principal** | **Allowance** |
| Agricultural | $ | 21,707,687 | 864,021 |
| Commercial | | 21,014,640 | 6,561,489 |
| Services | | 32,729,958 | 6,357,573 |
| Manufacturing | | 6,154,509 | 703,471 |
| Tourism | | 11,898,489 | 1,392,519 |
| | $ | 93,505,283 | 15,879,073 |

The following tables present the troubled debt restructuring modified during the years ended June 30, 2014 and 2013:

| | | 2014 | |
|---|---|---|---|
| | | **Pre modification** | **Post modification** |
| Outstanding recorded investment | $ | 26,371,593 | 26,396,303 |
| Number of Contracts | | 100 | 100 |
| Weighted average rate | | 5.87% | 5.56% |
| Weighted average term (months) | | 71 | 95 |

| | 2013 | |
|---|---|---|
| | **Pre modification** | **Post modification** |
| Outstanding recorded investment | $ 11,941,009 | 11,936,417 |
| Number of Contracts | 33 | 33 |
| Weighted average rate | 5.38% | 5.53% |
| Weighted average term (months) | 68 | 74 |

Of the total troubled debt restructurings during 2014 and 2013, 17 contracts with a balance at June 30, 2014 of $3,682,000 and 8 contracts with a balance at June 30, 2013 of $245,000, defaulted after their modifications were processed.

At June 30, 2014 and 2013, commitments to extend credit on troubled debt restructured loans amounted to $403,000 and $580,000, respectively.

Changes in the total allowance for loan losses for the years ended June 30, 2014 and 2013 were as follows:

| | **2014** | **2013** |
|---|---|---|
| Balance, beginning of year | $ 35,734,173 | 31,000,686 |
| Provision charged to operations | 10,960,000 | 10,788,145 |
| Loans charged off as uncollectible | (14,941,246) | (9,503,884) |
| Recoveries | 2,268,616 | 3,449,226 |
| Balance, end of year | $ 34,021,543 | 35,734,173 |

The following table presents the changes and the balance in the allowance for loan losses and the recorded investment in gross loans by industry sector and based on impairment method for the year ended June 30, 2014 and 2013:

| | | 2014 | | | | | |
|---|---|---|---|---|---|---|---|
| | | **Agricultural** | **Commercial** | **Services** | **Manufacturing** | **Tourism** | **Total** |
| Allowance for loan losses: | | | | | | | |
| Beginning balance | $ | 2,061,237 | 12,305,535 | 15,746,072 | 2,537,066 | 3,084,263 | 35,734,173 |
| Provision charged to operations | | 820,734 | 4,228,979 | 3,673,024 | 1,368,295 | 868,968 | 10,960,000 |
| Loans charged-off as uncollectible | | (416,801) | (6,629,048) | (4,731,192) | (1,033,096) | (2,131,109) | (14,941,246) |
| Recoveries | | 458,879 | 360,008 | 716,211 | 726,667 | 6,851 | 2,268,616 |
| Ending balance | $ | 2,924,049 | 10,265,474 | 15,404,115 | 3,598,932 | 1,828,973 | 34,021,543 |
| Ending allowance attributable to loans: | | | | | | | |
| Individually evaluated for impairment | $ | 2,094,044 | 5,563,223 | 4,638,304 | 1,110,531 | 230,822 | 13,636,924 |
| Collectively evaluated for impairment | | 830,005 | 4,702,251 | 10,765,811 | 2,488,401 | 1,598,151 | 20,384,619 |
| Ending allowance | $ | 2,924,049 | 10,265,474 | 15,404,115 | 3,598,932 | 1,828,973 | 34,021,543 |
| Loans: | | | | | | | |
| Individually evaluated for impairment | $ | 19,812,499 | 29,337,759 | 29,612,685 | 8,920,341 | 9,072,108 | 96,755,392 |
| Collectively evaluated for impairment | | 12,266,962 | 54,887,876 | 127,861,132 | 31,667,399 | 21,169,293 | 247,852,662 |
| Total loan balance | $ | 32,079,461 | 84,225,635 | 157,473,817 | 40,587,740 | 30,241,401 | 344,608,054 |

| | 2013 | | | | | |
|---|---|---|---|---|---|---|
| | **Agricultural** | **Commercial** | **Services** | **Manufacturing** | **Tourism** | **Total** |
| Allowance for loan losses: | | | | | | |
| Beginning balance | $ 2,432,530 | 9,886,986 | 13,766,960 | 3,872,834 | 1,041,376 | 31,000,686 |
| Provision charged to operations | 1,210,223 | 2,121,162 | 3,387,557 | 1,830,489 | 2,238,714 | 10,788,145 |
| Loans charged-off as uncollectible | (2,050,448) | (1,566,270) | (2,225,023) | (3,448,396) | (213,747) | (9,503,884) |
| Recoveries | 468,932 | 1,863,657 | 816,578 | 282,139 | 17,920 | 3,449,226 |
| Ending balance | $ 2,061,237 | 12,305,535 | 15,746,072 | 2,537,066 | 3,084,263 | 35,734,173 |
| Ending allowance attributable to loans: | | | | | | |
| Individually evaluated for impairment | $ 401,410 | 7,413,938 | 5,611,234 | 651,416 | 1,259,185 | 15,337,183 |
| Collectively evaluated for impairment | 1,659,827 | 4,891,597 | 10,134,838 | 1,885,650 | 1,825,078 | 20,396,990 |
| Ending allowance | $ 2,061,237 | 12,305,535 | 15,746,072 | 2,537,066 | 3,084,263 | 35,734,173 |
| Loans: | | | | | | |
| Individually evaluated for impairment | $ 17,519,633 | 23,816,825 | 26,985,842 | 8,163,708 | 10,270,768 | 86,756,776 |
| Collectively evaluated for impairment | 16,101,835 | 51,818,468 | 110,841,516 | 21,931,897 | 22,056,847 | 222,750,563 |
| Total loan balance | $ 33,621,468 | 75,635,293 | 137,827,358 | 30,095,605 | 32,327,615 | 309,507,339 |

## (5) Capital Assets

Capital assets activity for the years ended June 30, 2014 and 2013 was as follows:

| | 2014 | | | |
|---|---|---|---|---|
| | **Beginning balance** | **Increases** | **Decreases** | **Ending balance** |
| Land | $ 2,735,000 | — | — | 2,735,000 |
| Building and improvements | 11,340,844 | 169,243 | — | 11,510,087 |
| Furniture and equipment | 4,946,471 | 114,039 | (42,705) | 5,017,805 |
| Total cost | 19,022,315 | 283,282 | (42,705) | 19,262,892 |
| Less accumulated depreciation and amortization: | | | | |
| Building and improvements | (5,324,544) | (291,973) | — | (5,616,517) |
| Furniture and equipment | (4,805,750) | (69,912) | 42,705 | (4,832,957) |
| Total accumulated depreciation and amortization | (10,130,294) | (361,885) | 42,705 | (10,449,474) |
| Capital assets, net | $ 8,892,021 | (78,603) | — | 8,813,418 |

| | 2013 | | | |
|---|---|---|---|---|
| | **Beginning balance** | **Increases** | **Decreases** | **Ending balance** |
| Land | $ 2,735,000 | — | — | 2,735,000 |
| Building and improvements | 11,281,593 | 59,251 | — | 11,340,844 |
| Furniture and equipment | 4,933,199 | 42,724 | (29,452) | 4,946,471 |
| Total cost | 18,949,792 | 101,975 | (29,452) | 19,022,315 |
| Less accumulated depreciation and amortization: | | | | |
| Building and improvements | (5,035,270) | (289,274) | — | (5,324,544) |
| Furniture and equipment | (4,731,681) | (103,521) | 29,452 | (4,805,750) |
| Total accumulated depreciation and amortization | (9,766,951) | (392,795) | 29,452 | (10,130,294) |
| Capital assets, net | $ 9,182,841 | (290,820) | — | 8,892,021 |

The Bank's principal premises are partially rented to various lessees under lease terms expiring at various future dates. Minimum future rentals to be received for the next two years ended June 30, 2015 and 2016 are approximately $360,000 and $319,000, respectively.

Rent revenue amounting to approximately $304,000 and $309,000 was recorded as other income in the accompanying 2014 and 2013 statements of revenue, expenses, and changes in net position, respectively.

## (6) Other Assets

Other assets as of June 30, 2014 and 2013 consist of the following:

| | 2014 | 2013 |
|---|---|---|
| Other real estate owned, net of allowance for losses of $5,935,941 in 2014 and $6,872,042 in 2013 | $ 6,991,835 | 8,169,180 |
| Deferred issuance costs | 108,073 | 117,082 |
| Accounts receivable from other Commonwealth component units | 775,826 | 65,516 |
| Other | 468,975 | 142,662 |
| Total | $ 8,344,709 | 8,494,440 |

## (7) Time Deposits

Time deposits of $411,683,945 and $330,317,694 at June 30, 2014 and 2013, respectively, consist of deposits with fixed maturity dates (not exceeding 12 months) received from other governmental institutions, commercial banks, or other financial institutions. Governmental time deposits (Commonwealth and its component units) are exempt by law from the collateral requirement applicable to commercial financial institutions, which are depositors of public funds. Governmental time deposits at June 30, 2014 and 2013 amounted to approximately $390,330,000 and $290,040,000, respectively.

Time deposits in denominations of $100,000 or more amounted to approximately $411,540,000 and $330,273,000 at June 30, 2014 and 2013, respectively.

## (8) Securities Sold under Agreements to Repurchase

The Bank's investment policies, as authorized by Act number 22 of July 24, 1985, Article 3, allow management to sell securities under agreements to repurchase. The following table summarizes certain information on securities sold under agreements to repurchase:

| | | 2014 | 2013 |
|---|---|---|---|
| Carrying amount at June 30 | $ | 45,690,000 | 76,200,000 |
| Average amount outstanding during the year | | 59,824,000 | 113,889,000 |
| Maximum amount outstanding at any month-end | | 75,750,000 | 268,739,000 |
| Weighted average interest rate for the year | | 1.07% | 1.42% |
| Weighted average interest rate at year-end | | 0.35 | 1.40 |

Securities sold under agreements to repurchase represent borrowings with maturities ranging from 10 to 71 days at June 30, 2014 and from 10 to 270 days at June 30, 2013.

As of June 30, 2014 and 2013, securities sold under agreements to repurchase were collateralized with mortgage-backed securities, other government agencies securities, and other investments with a market value of $50,099,000 and $81,051,000, respectively.

The activity for securities sold under agreements to repurchase during 2014 and 2013 was as follows:

| | | 2014 | | | | |
|---|---|---|---|---|---|---|
| | | Beginning balance | Increases | Decreases | Ending balance | Amounts due within one year |
| Securities sold under agreement to repurchase | $ | 76,200,000 | 248,690,000 | (279,200,000) | 45,690,000 | 45,690,000 |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | **Beginning balance** | **Increases** | **Decreases** | **Ending balance** | **Amounts due within one year** |
| Securities sold under agreement to repurchase | $ 123,925,000 | 610,079,000 | (657,804,000) | 76,200,000 | 76,200,000 |

## (9) Promissory Notes and Other Note Payable

Promissory notes and other note payable at June 30, 2014 and 2013 are summarized as follows:

| | 2014 | 2013 |
|---|---|---|
| Promissory notes | $ 441,214,688 | 703,047,620 |
| Other note payable | 8,922,920 | 9,421,905 |
| Total | $ 450,137,608 | 712,469,525 |

On May 22, 2003, the Bank was authorized to issue up to $300 million in collateralized promissory notes. During the fiscal year 2005, the authorized amount was increased up to $500 million. During fiscal year 2008, the Bank, through its subsidiary EDBCI, was authorized to issue an additional $275 million in collateralized promissory notes. The proceeds received by the Bank from the sale of these notes shall be invested in obligations that qualify as permitted investments under applicable laws and the investment guidelines adopted by the Bank. Such notes have maturities not exceeding 20 years. These notes contain certain put options held by the Bank and by the creditor. The put options of the Bank grant the Bank the exercisable right, at the Bank's sole discretion, to require the noteholder to purchase, on established exercise dates, the collateral of this note at a price equal to the amortized cost of the promissory notes, as defined. The put option held by the noteholders permits them, on the same established dates of the Bank's put option, to require the Bank to redeem the promissory notes at their outstanding amortized cost. The mirror put options held by the Bank are considered in accounting for the fair value of the underlying investments. As a result, no separate asset or obligation is recorded related to the put options.

At June 30, 2014 and 2013, the aggregate principal balance of promissory notes outstanding under these programs amounted to $441 million and $703 million, respectively. These notes pay interest semiannually, bear interest rates at June 30, 2014 ranging from 1.83% to 5.81%, and mature at various dates through September 27, 2032. These promissory notes are collateralized with investment securities with an aggregate fair value of $469,577,000, excluding the value of their corresponding put options.

The other note payable is due to the Government Development Bank of Puerto Rico (GDB) (collateralized by a real estate mortgage) bears interest at the rate of 6% per annum, pays interest semiannually in June and December, and principal is paid each June. The note matures on June 1, 2026 and provides for annual payments of $1,064,300 including interest.

Promissory notes and other note payable activity for the years ended June 30, 2014 and 2013 was as follows:

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Beginning balance | Increases | Decreases | Ending balance | Amounts due within one year |
| Promissory notes | $ 703,047,620 | — | (261,832,932) | 441,214,688 | — |
| Other note payable | 9,421,905 | — | (498,985) | 8,922,920 | 528,924 |
| Total promissory notes and other notes payable | $ 712,469,525 | — | (262,331,917) | 450,137,608 | 528,924 |

| | 2013 | | | | |
|---|---|---|---|---|---|
| | Beginning balance | Increases | Decreases | Ending balance | Amounts due within one year |
| Promissory notes | $ 726,140,838 | 150,003,356 | (173,096,574) | 703,047,620 | — |
| Other note payable | 9,892,646 | — | (470,741) | 9,421,905 | 498,985 |
| Total promissory notes and other notes payable | $ 736,033,484 | 150,003,356 | (173,567,315) | 712,469,525 | 498,985 |

The maturities and interest payments of the promissory notes and the note payable for each of the next five fiscal years and thereafter are as follows:

| | Principal | Interest |
|---|---|---|
| Year ending June 30: | | |
| 2015 | $ 528,924 | 20,613,085 |
| 2016 | 11,724,896 | 20,442,234 |
| 2017 | 594,299 | 20,343,201 |
| 2018 | 629,957 | 20,307,365 |
| 2019 | 667,755 | 20,269,378 |
| 2020–2024 | 271,333,498 | 67,194,944 |
| 2025–2029 | 14,658,279 | 23,658,855 |
| 2030–2034 | 150,000,000 | 15,099,583 |
| | $ 450,137,608 | 207,928,645 |

## (10) Other Liabilities

The activity for the other noncurrent liabilities during 2014 and 2013 was as follows:

| | 2014 | | | |
|---|---|---|---|---|
| | Beginning balance | Increases | Decreases | Ending balance |
| Compensated absences | $ 2,013,212 | 320,000 | (283,623) | 2,049,589 |
| Legal claims | 667,722 | — | — | 667,722 |
| Reserve for loan guarantees | 3,641,970 | — | (17,800) | 3,624,170 |
| | $ 6,322,904 | 320,000 | (301,423) | 6,341,481 |

| | 2013 | | | |
|---|---|---|---|---|
| | Beginning balance | Increases | Decreases | Ending balance |
| Compensated absences | $ 2,123,279 | 372,000 | (482,067) | 2,013,212 |
| Legal claims | 686,222 | — | (18,500) | 667,722 |
| Reserve for loan guarantees | 5,225,937 | — | (1,583,967) | 3,641,970 |
| | $ 8,035,438 | 372,000 | (2,084,534) | 6,322,904 |

## (11) Net Position

The Bank's net position invested in capital assets and restricted as of June 30, 2014 and 2013 are composed of the following:

| | 2014 | 2013 |
|---|---|---|
| Net investment in capital assets | | |
| Capital assets | $ 19,262,892 | 19,022,315 |
| Accumulated depreciation and amortization | (10,449,474) | (10,130,294) |
| Related GDB note | (8,922,920) | (9,421,905) |
| Total | $ (109,502) | (529,884) |
| Restricted for special loan programs: | | |
| Economic Development Administration | $ 3,587,156 | 3,653,995 |
| Day Care Centers Loan Fund | 4,660,894 | 4,650,191 |
| State Small Business Credit Initiative | 9,828,706 | 4,955,228 |
| Total | $ 18,076,756 | 13,259,414 |

The Bank is a recipient of two grants from the Economic Development Administration Directive System (EDA), subscribed by the U.S. Department of Commerce to operate a program under a Revolving Loan

Fund directed to assist businesses that suffered physical or economic damage due to the effects of Hurricane Hugo, and to advance the economic development of Puerto Rico. The Bank matched EDA's award pursuant to the terms of the grant agreements. The funds received from the collection of principal and interest of loans granted under the program are deposited in the fund to be used to disburse new qualified loans. At June 30, 2014 and 2013, the outstanding principal of loans granted under the terms of EDA Revolving Loan Fund amounted to $3,126,828 and $2,865,912, respectively, and are included in loans, net in the accompanying statements of net position. The grants are routinely subject to financial and compliance audits in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133 or to compliance audits by EDA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance.

On October 6, 1989, a revolving loan fund grant that was administrated by GDB was transferred to the Bank for administration under the same terms as when the program was established by GDB. At the time, such fund had a total contribution of $1,250,000 ($1,000,000 from EDA and $250,000 from GDB) and a portfolio consisting of 15 loans with an aggregate outstanding principal balance of $504,299. The fund was pooled into the fund previously administered by the Bank when the Bank reimbursed $250,000 to GDB for their original contribution to such fund. As a result, the Bank's contribution to the fund equals 25% of EDA's contribution to the fund.

The Commonwealth approved Law No. 212 of August 29, 2000, as amended, which creates the Day Care Centers Loan Fund, for the purpose of financing the development of day care centers for children, multiple activity centers for elderly persons, and long-term care institutions. The Bank is responsible for the administration of the fund. At June 30, 2014 and 2013, the outstanding principal of loans granted under the terms of the Day Care Centers Loan Fund amounted to $2,499,464 and $2,733,776, respectively, and are included in loans, net in the accompanying statements of net position.

In September 2011, the Bank was approved an allocation of $14.5 million from the U.S. Department of the Treasury (Treasury) under the State Small Business Credit Initiative Act of 2010, Title 3 of the Small Business Jobs Act of 2010 (SSBCI), by which the United States Congress appropriated funds to Treasury to be allocated and disbursed to States and Territories that have created programs to increase the amount of capital made available by private lenders to small businesses. To accomplish this Puerto Rico will use $12.5 million of its allocated SSBCI funds to support the existing Loan Participation Program and $2 million to support the existing Venture Capital Program. As of June 30, 2014, the Bank has received $9.6 million of the total allocation, which was recorded as a capital contribution, and has committed $7.7 million under the Loan Participation Program and $1 million under the Venture Capital Program.

Net position restricted for the special loans programs as of June 30, 2014 and 2013 consist of the following:

| | | 2014 | 2013 |
|---|---|---|---|
| Cash and due from banks | $ | 7,457,754 | 5,760,600 |
| Venture capital investment | | 1,000,000 | — |
| Loans and interest receivable, net of allowance for loan losses of $943,196 and $896,676 in 2014 and 2013, respectively | | 9,604,267 | 8,408,251 |
| Other assets | | 173,962 | 520,448 |
| Total restricted assets | | 18,235,983 | 14,689,299 |
| Accounts payable and other liabilities | | 159,227 | 1,429,885 |
| Total restricted net assets | $ | 18,076,756 | 13,259,414 |

## (12) Interagency Agreements

The Bank has entered into interagency agreements with various government agencies. Such agreements provide for the deposit of funds in the Bank amounting in the aggregate to approximately $2.8 million to be used for loan programs to benefit socially and economically disadvantaged families and unemployed persons. Loans are granted based on the requirements established by such governmental agencies and the Bank is responsible for the administration of the loan portfolio. During the fiscal year ended June 30, 2014, these fund programs made payments of approximately $15,000 to the Bank for loans guaranteed; therefore, these loans are not included in the accompanying statements of net position.

The Bank entered into an interagency agreement with the Economic Development and Commerce Department (a governmental unit of the Commonwealth). Such agreement provides for the transfer of the funds from the previously created Hurricane Georges Guarantee Loan Fund and the Education Loan Program Guarantee Fund to a new loan fund program. The new loan fund program grants direct loans and guarantees to small- and medium-sized entrepreneurs in the economic sectors of manufacturing, services, and commerce. Guarantee claims under Hurricane Georges Guarantee Loan Fund and Education Loan Program Guarantee Fund may be paid by the new fund. At June 30, 2014 and 2013, the outstanding principal of loans granted under all the Economic Development and Commerce Department loans and loan guarantee programs amounted to $3,653,198 and $4,908,572, respectively, of which $3,059,171 and $3,395,918, respectively, are included in loans, net in the accompanying statements of net position, while the remaining balance had been paid to the Bank by the new fund.

The Bank entered into an interagency agreement with the Tourism Company of Puerto Rico (a component unit of the Commonwealth) to create the Loan and Guarantee Tourism Fund. At June 30, 2014 and 2013, the outstanding principal of loans granted under this fund amounted to $6,684,778 and $6,857,847, respectively, and are included in loans, net in the accompanying statements of net position.

On August 17, 2001, the Commonwealth approved Law No. 117, which creates the Agricultural Guarantee Loan Fund to secure loans granted by the Bank and commercial banks to farmers and agricultural entities.

This fund will be financed through annual appropriations to be provided by the Commonwealth up to $100 million during a four-year period. The Bank has entered into an alliance with the Commonwealth's Department of Agriculture (the Department) for the administration of this fund, which among other things, requires that the Department establish the operational procedures of the Fund, while the Bank will administer the fund. At June 30, 2008, the fund had received $10 million related to the initial appropriation, which was deposited in the Bank. At June 30, 2014 and 2013, the outstanding principal of all loans granted under the Agricultural Guarantee Loan Fund program amounted to $7,461,178 and $8,552,287, respectively, of which $5,128,560 and $5,423,230, respectively, are included in loans, net in the accompanying statements of net position, while the remaining balance had been paid to the Bank by the fund.

The Bank entered into an interagency agreement with the Department of Agriculture (a governmental unit of the Commonwealth) and the Fund for the Comprehensive Development of the Agriculture, a component unit of the Puerto Rico Land Authority (a component unit of the Commonwealth), to create the Guarantee Loan Program – "La Llave para tu Agro-empresa." At June 30, 2014 and 2013, the outstanding principal of loans granted under the program amounted to $631,766 and $1,160,877, respectively, of which $258,349 and $458,716, respectively, are included in loans, net in the accompanying statements of net position, while the remaining balance had been paid to the Bank by the fund.

The financial statements of the funds are audited by other independent auditors whose reports thereon for the year ended June 30, 2013, dated December 31, 2013, express an unqualified opinion. Audit of these funds for the year ended June 30, 2014 has not been completed as of issuance date of the Bank's basic financial statements. These funds are not included within the Bank's basic financial statements.

The Bank and the governmental agencies participating in the interagency agreements described above are jointly liable for any litigation that may arise in connection with the administration of such loan programs. At June 30, 2014 and 2013, there was no pending or threatened litigation under such programs.

## (13) Commitments and Contingencies

### *(a) Litigation*

At June 30, 2014, the Bank is a defendant in various lawsuits arising from the ordinary course of business. Management, after consultation with legal counsel, is of the opinion that the ultimate liability, if any, resulting from such lawsuits would not be material in relation to the Bank's financial position and results of operations.

Because of the uncertainties inherent in the evaluation of pending or threatened litigation, the Bank's ultimate liability under such claims may be significantly different from management's current estimate.

### *(b) Loan Guarantee Program*

On March 9, 2009, the Commonwealth approved Law No. 9, which creates the Loan Guarantees Program for the Small and Medium Businesses. Under the program, the GDB, a component unit of the Commonwealth, assigned $180 million to the Bank to secure loans granted by commercial banks and other financial institutions ranging from $5,000 to $250,000 and in accordance with the criteria established by the law and the Bank's policies. The purpose of this program is to facilitate credit to enterprises affected by lack of liquidity or lack of sufficient collateral to back up their loans. At June 30, 2014 and 2013, the outstanding principal of loans granted under the program amounted to $3,050,000 and $3,080,000, respectively.

At June 30, 2014 and 2013, total outstanding loan guarantees, including guarantees under the new program mentioned above, amounted to approximately $3,201,000 and $3,231,000, respectively. The Bank has recorded a reserve for loan guarantees amounting to approximately $1,922,000 and $1,938,000 at June 30, 2014 and 2013, respectively, which is included in other current liabilities in the accompanying statements of net position. During 2011, the Bank received $10 million from the GDB to cover any losses that may arise from the operation of the Loan Guarantees Program described above. This amount was recorded in the reserve for loan guarantees under noncurrent other liabilities in the accompanying financial statements. See note 20 on related-party transactions.

From the reserve for loan guarantees, which as of June 30, 2014 has a balance of $3,454,000, the Bank reassigned during 2011 $5 million for disbursements of loans under the "Desarrollo para el Pueblo" program and $2 million for disbursements of loans under the "Vieques y Culebra" program. Up to June 30, 2014, $5.5 million have been disbursed for the two programs, leaving $1.5 million in the reserve for this purpose. In addition, the reserve for loan guarantees includes $1.9 million to cover the $3.1 million in guarantees outstanding as of June 30, 2014. See also note 20.

***(c) Other Risks***

The Bank is exposed to various risks of loss related to torts, theft, casualty, errors, and omissions and other losses for which the Bank carries commercial insurance. Settled claims have not exceeded insurance coverage in any of the past three fiscal years. Also, the Bank obtains workers' compensation coverage from another component unit of the Commonwealth.

## (14) Significant Group Concentrations of Credit and Market Risk

The Bank's business activities are with customers located in Puerto Rico. The Bank's loan transactions are all directed toward small- and medium-size businesses in all sectors of Puerto Rico's economy. The collateral held on the Bank's loans varies, but usually includes chattel and real estate mortgages.

## (15) Retirement Plans

***(a) Defined Benefit Pension Plan***

The Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) created pursuant to Act No. 447 of 1951, as amended, is a cost sharing multiple employer defined benefit pension plan sponsored by and reported as a component unit of the Commonwealth. All regular employees of the Bank hired before January 1, 2000 and under 55 years of age at the date of employment became members of the ERS as a condition to their employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

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

### *(b) Defined Contribution Plan*

The Legislature of the Commonwealth enacted Act No. 305 of 2000, which amends Act No. 447, to establish, among other things, a new defined benefit contribution savings plan program (System 2000).

System 2000 became effective on January 1, 2000. Employees participating in the System as of December 31, 1999 elected either to stay in the defined benefit plan or to transfer to System 2000. New regular employees of the government on or after January 1, 2000 became members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which is invested by the System, together with those of the System. Benefits at retirement age will not be guaranteed by the Commonwealth.

### *(c) New Defined Contribution Hybrid Program*

In April 2013, the Legislature of the Commonwealth enacted Act No. 3, which amends Acts No. 447 of 1951 and 305 of 2000, to establish, among other things, the creation of a new defined contribution hybrid program and amend the terms and conditions of the benefits structure granted to active participants and pensioners under the previously established benefit structures administered by the ERS.

The Hybrid Program became effective on July 1, 2013. Employees participating in the System as of June 30, 2014 retained their rights to receive the benefits earned under the previous program based on the accumulated salaries and years of service up to June 30, 2014. All employees of the government on or after July 1, 2013 became members of the Hybrid Program.

The Hybrid Program is a defined contribution plan. Under this new plan, there is a pool of pension assets, which is invested by the System, together with those of the System. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on the employees' contribution (with a minimum of 10% of the employees' salary and no maximum amount, limited by annual increments of up to 0.5% of the monthly gross salary), which will be invested in one of three investment options.

Pension benefits are defined as of June 30, 2013 based on the member status. Members who entered the ERS before April 1, 1990 and who have attained 58 years of age and at least 10 years of creditable service, or members who have attained 55 years of age and at least 25 years of creditable service, are entitled to a deferred pension plus the benefits of the new defined contribution hybrid program annuity. Members who have attained 57 years and at least 10 years of creditable service will be eligible for benefits once they have 59 years. Members who have attained 56 years and at least 10 years of creditable service will be eligible for benefits once they have 60 years. Members who have not attained 56 years and have completed at least 10 years of creditable service will be eligible for benefits once they have 61 years.

Members entering the ERS on or after April 1, 1990 but before December 31, 1999 and who have attained 65 years are entitled to a deferred pension plus the benefits of the new defined contribution hybrid program annuity.

Members entering the ERS after January 1, 2000 and who have attained 59 years as of June 30, 2013 are entitled to the defined contribution program annuity. Members who have attained 58 years as of June 30, 2013 are entitled to the defined contribution program annuity once they have attained 62 years. Members who have attained 57 years as of June 30, 2013 are entitled to the defined contribution program annuity once they have attained 63 years. Members who have attained 56 years as of June 30, 2013 are entitled to the defined contribution program annuity once they have attained 64 years. Members who have attained 55 years or less as of June 30, 2013 are entitled to the defined contribution program annuity once they have attained 65 years.

The Bank's required contribution is 12.275% of the employees' salary. Contribution rates are established commonwealth wide for all participating governmental units. Accordingly, the actuarial information and related disclosures attributable to the Bank's employees are not determinable.

Total employee contributions during the years ended June 30, 2014, 2013 and 2012 to the above plans amounted to approximately $556,000, $444,000 and $458,000, respectively. Total payroll covered for the years ended June 30, 2014 and 2013 was approximately $5,610,000 and $5,369,000, respectively.

The Bank's contributions during the years ended June 30, 2014, 2013 and 2012 to the above plans amounted to $689,000, $605,000, and 616,000, respectively, which represented 100% of required contributions.

Employee retirement system publishes an annual report that provides information on progress made in accumulating sufficient assets to pay benefits when due. That report may be obtained by writing to Employees' Retirement System of the Commonwealth and its Instrumentalities, P.O. Box 42003, San Juan, PR 00940-2003.

## (16) Financial Instruments with Off-Balance-Sheet Risk

In the normal course of business, the Bank is a party to financial instruments with off-balance-sheet risk to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit and to purchase investment and mortgage-backed securities, financial guarantees, and interest rate exchange agreements. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of amounts recognized in the accompanying statements of net position. These off-balance-sheet risks are managed and monitored in manners similar to those used for on-balance-sheet risks. The Bank's exposures to credit losses for lending commitments are represented by the contractual amount of such transactions. The notional amounts for other off-balance-sheet risks express the dollar volume of the transactions, but the credit risk might be lower.

At June 30, 2014 and 2013, the off-balance-sheet risks consisted of the following:

| | | 2014 | 2013 |
|---|---|---|---|
| | | (In thousands) | |
| Financial instruments whose credit is represented by contractual amounts: | | | |
| Financial guarantees | $ | 3,201 | 3,231 |
| Commitments to extend credit | | 23,935 | 41,156 |
| Commitments to invest in venture capital | | 7,004 | 8,218 |

Financial guarantees written are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support private borrowing arrangements. The credit risk involved in issuing financial guarantees is essentially the same as that involved in extending loan facilities to customers.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include property, plant, and equipment, and income-producing commercial properties.

## (17) Other Noninterest Income

Other noninterest income for the years ended June 30, 2014 and 2013 consists of the following:

| | | 2014 | 2013 |
|---|---|---|---|
| Rental income (note 5) | $ | 303,831 | 308,515 |
| (Loss) gain on sale of foreclosed assets | | (172,693) | 12,750 |
| Administrative fees – other funds | | 42,033 | 43,723 |
| Recoveries from loan guarantees | | 30,800 | 68,317 |
| Miscellaneous income | | 232,584 | 278,865 |
| Total | $ | 436,555 | 712,170 |

## (18) Other Noninterest Expenses

Other noninterest expenses for the years ended June 30, 2014 and 2013 consist of the following:

| | | 2014 | 2013 |
|---|---|---|---|
| Electricity | $ | 467,807 | 489,355 |
| Insurance | | 199,092 | 200,349 |
| Repairs and maintenance | | 204,933 | 188,473 |
| Telephone | | 40,350 | 43,725 |
| Employees trainings and seminars | | 10,596 | 3,260 |
| Office supplies | | 52,872 | 61,592 |
| Reimbursement of expenses to employees | | 49,218 | 68,161 |
| Dues and subscriptions | | 63,654 | 50,912 |
| Investment operations | | 28,695 | 34,404 |
| Vehicles | | 18,633 | 18,428 |
| Postage | | 25,723 | 31,062 |
| Official meetings | | 5,308 | 7,628 |
| Miscellaneous | | 436,156 | 449,223 |
| Subtotal | | 1,603,037 | 1,646,572 |
| Provision for losses on loan guarantees | | 16,250 | 1,061,855 |
| Provision for losses on foreclosed assets | | 900,000 | 1,000,000 |
| Total | $ | 2,519,287 | 3,708,427 |

## (19) Related-Party Transactions

On February 1, 2010, the Governor of Puerto Rico issued Executive Order OE-2010-005, which reassigned funds remaining from the local economic stimulus plan approved under Law No. 9 of the Commonwealth in March 9, 2009. In accordance with this order, the Bank received from GDB $41,250,000 to implement a program designed to promote the economic capacity of small- and medium-size enterprises. Of this total, the Bank recorded $30 million as a capital contribution aimed to generate new direct loans, $10 million as a reserve for possible losses from the Loan Guarantee Program created by the abovementioned Law No. 9, and $1,250,000 as an accrual for expenses related to a government wide effort to promote economic development of the small- and medium-size enterprise sector.

As mentioned in note 13 above, during 2011, $7 million from the reserve for possible losses from the Loan Guarantee Program were reassigned for the disbursement of loans under the “Desarrollo para el Pueblo” and “Vieques y Culebra” programs. Accordingly, approximately $1,500 and $1,363,000 were disbursed under these programs during 2014 and 2013, respectively, and reclassified from the reserve account to capital contribution. In addition, during 2014 and 2013, the Bank disbursed approximately $16,250 and $1,095,000, respectively, to pay loan guarantees to commercial banks under the Loan Guarantee Program created by the abovementioned Law No. 9.

## (20) Subsequent Events

The Bank evaluated subsequent events through October 22, 2014, the date the basic financial statements were available to be issued.