



guzmán torres & co., psc
certified public accountants & business advisors

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

AUDITED FINANCIAL STATEMENTS
FOR THE YEARS ENDED JUNE 30, 2011 AND 2010
TOGETHER WITH INDEPENDENT AUDITORS' REPORT

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

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INDEPENDENT AUDITORS' REPORT

Hon. Rubén A. Hernández Gregorat, MEM, P.E.
Secretary Department of Transportation and Public Works

We have audited the accompanying statements of net assets of Puerto Rico Metropolitan Bus Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2011 and 2010, and the related statements of revenues, expenses and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our 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 of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Metropolitan Bus Authority at June 30, 2011 and 2010 and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

The management's discussion and analysis on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Guzmán Torres & Co., P.S.C.
Certified Public Accountants
October 28, 2011

Stamp # **2624431**
was affixed to
the original of
this report.

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

The following discussion and analysis of the financial performance and activity of the Puerto Rico Metropolitan Bus Authority ("the Authority") provides an introduction and understanding of the basic financial statements of the Authority for the fiscal years ended June 30, 2011 and 2010. This discussion was prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Financial Highlights for 2011

- Net assets deficiency totaled \$11.5 million at June 30, 2011.
- Net assets deficiency decreased by \$1.3 million in 2011, as compared to a decrease of approximately \$6.8 million in 2010.
- Net capital assets totaled \$66.7 million at June 30, 2011
- Net capital assets increased by 3.3% at June 30, 2011, when compared with the balance at June 30, 2010 of \$64.6 million.

Financial Highlights for 2010

- Net assets deficiency totaled \$12.7million at June 30, 2010.
- Net assets deficiency decreased by \$6.8 million in 2010, as compared to an increase of approximately \$21.5 million in 2009.
- Net capital assets totaled \$64.6 million at June 30, 2010
- Net capital assets increased by 13% at June 30, 2010, when compared with the balance at June 30, 2009 of \$51.5 million.

The Financial Statements

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

Overview of the Financial Statements for Business-Type Activities

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

Statement of Net Assets

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

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

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

Statement of Revenues, Expenses, and Changes in Net Assets

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

Statement of Cash Flows

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

PUERTO RICO METROPOLITAN BUS AUTHORITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

Notes to Financial Statements

The notes to financial statements are an integral part of the basic financial statements and describe the significant accounting policies, related-party transactions, deposits and investments, capital assets, long-term liabilities, defined-benefit pension plans, and the commitments and contingencies. The reader is encouraged to review the notes in conjunction with the management discussion and analysis and the financial statements.

Financial Analysis of the Authority's Business-Type Activities

Statements of Net Assets

The following table reflects a condensed summary of assets, liabilities, and net assets of the Authority as of June 30, 2011, 2010, and 2009:

	June 30,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
ASSETS			
Current assets	\$ 18,108,854	\$ 31,217,692	\$ 10,712,321
Capital assets	66,708,273	64,555,810	51,519,173
Other assets	<u>542,071</u>	<u>542,071</u>	<u>267,071</u>
Total assets	<u>\$ 85,359,198</u>	<u>\$ 96,315,573</u>	<u>\$ 62,498,565</u>
LIABILITIES			
Current liabilities	\$ 93,048,728	\$ 73,379,949	\$ 44,656,321
Long-term liabilities	<u>3,824,836</u>	<u>35,689,966</u>	<u>37,409,974</u>
Total liabilities	<u>96,873,564</u>	<u>109,069,915</u>	<u>82,066,295</u>
NET ASSETS			
Invested in capital assets, net of related debt	58,447,055	47,417,211	51,519,173
Deficiency in unrestricted net assets	<u>(69,961,421)</u>	<u>(60,171,553)</u>	<u>(71,086,903)</u>
Total net assets deficiency	<u>(11,514,366)</u>	<u>(12,754,342)</u>	<u>(19,567,730)</u>
Total liabilities and net assets	<u>\$ 85,359,198</u>	<u>\$ 96,315,573</u>	<u>\$ 62,498,565</u>

PUERTO RICO METROPOLITAN BUS AUTHORITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

June 30, 2011

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

Capital assets increased by 3.3% to \$66.7 million principally for the acquisition of transportation equipment net of related depreciation for the year. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the U.S. Federal Transit Administration which is used to finance the acquisition and maintenance of capital assets. Total capital grants received during fiscal year 2011 from the Commonwealth of Puerto Rico and the Transit Administration amounted to approximately \$12.2 million.

Current liabilities increased by 26.80% to \$93 million. This increase consists principally of an increase in current portion of long-term debt of \$34 million as explained below.

Long-Term Debt consists principally of amounts due to Scotia Bank of Puerto Rico related to a long-term financing obtained in prior years. The loan with Scotia Bank is payable in monthly principal installment of \$143,334 plus interests at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2011) due in February 12, 2012. Management is in the process of negotiating a refinancing of this debt on a long-term basis with the bank. However since no final agreement has being reached with the bank, the balance outstanding at June 30, 2011 has being classified as a current liability. The remaining long-term debt consists of the long-term portion of a voluntary retirement program implemented during this year as explained below.

Net assets deficiency decreased 9.7% to a net deficiency of \$11.5 million. This decrease was the result of an excess of revenues (operating and non-operating) over expenses (operating and non-operating) and capital grants of \$1.3 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

June 30, 2010

Current assets increased by 191.4% to \$31.3 million. The change in current assets is primarily due to an increase in the amount due by federal government related to capital contributions received after June 30, 2010.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

Capital assets increased by 13% to \$64.6 million principally for the acquisition of transportation equipment net of related depreciation for the year. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the Federal Transit Administration which is used to finance the acquisition of capital assets. Total capital grants received during fiscal year 2010 from the Commonwealth of Puerto Rico and the Transit Administration amounted to approximately \$22.9 million.

Current liabilities increased by 64.3% to \$73.3 million. This increase consists principally of an increase in accounts and accrued expenses payable. Accounts payable include approximately \$16 million for the acquisition of transportation equipment that will be paid with the capital contributions received from the Federal government after June 30, 2010.

Long-Term Debt consists principally of amounts due to Scotia Bank of Puerto Rico related to a long-term financing obtained in prior years. The loan with Scotia Bank is payable in monthly principal installment of \$143,334 plus interests at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2010) due in February 12, 2012.

Net assets deficiency decreased 35% to a net deficiency of \$12.8 million. This decrease was the result of an excess of revenues (operating and non-operating) over expenses (operating and non-operating) and capital grants of \$6.8 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

PUERTO RICO METROPOLITAN BUS AUTHORITY
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MANAGEMENT'S DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

The following table reflects a condensed summary of the revenues, expenses, and changes in net assets for the three years ended June 30, 2011:

	Years Ended June 30,		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues	\$ 9,248,546	\$ 6,313,102	\$ 24,403,044
Operating expenses	<u>88,747,879</u>	<u>85,153,876</u>	<u>85,542,546</u>
Operating loss	<u>(79,499,333)</u>	<u>(78,840,774)</u>	<u>(61,139,502)</u>
Non-operating revenues:			
Operating grants	73,723,710	66,952,499	42,193,592
Interest income (expense), net	<u>(5,166,258)</u>	<u>(4,131,901)</u>	<u>(5,014,845)</u>
Total non-operating revenues	<u>68,557,452</u>	<u>62,820,598</u>	<u>37,178,747</u>
Loss before capital contributions	(10,941,881)	(16,020,176)	(23,960,755)
Capital contributions	<u>12,181,857</u>	<u>22,833,564</u>	<u>2,500,000</u>
Change in net assets	1,239,976	6,813,388	(21,460,755)
Net assets deficit at beginning of year	<u>(12,754,342)</u>	<u>(19,567,730)</u>	<u>1,893,025</u>
Net assets deficit at end of year	<u>\$ (11,514,366)</u>	<u>\$ (12,754,342)</u>	<u>\$ (19,567,730)</u>

Year Ended June 30, 2011

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

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

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

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately \$3,972,000 in the statement of net assets as of June 30, 2011 and a charge of \$4,936,000 in the statement of activities for the year ended June 30, 2011. At June 30, 2011, unpaid long-term benefits granted on this program were discounted at 2.99%.

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

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

Year Ended June 30, 2010

Operating revenues which consisted principally of fares for transportation and other services, decreased by 74.1% to \$6.3 million. This decrease is due to a decrease in patronage during fiscal year 2010 as a result of general economic conditions. The Authority had a service contract with the Puerto Rico Highways and Transportation Authority (PRHTA) in which PRHTA paid the Authority a total of \$13.6 million for certain transportation services during the year ended June 30, 2009. This contract was cancelled effective February 2009. No amount was received under this contract during the year ended June 30, 2010.

PUERTO RICO METROPOLITAN BUS AUTHORITY

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MANAGEMENT'S DISCUSSION AND ANALYSIS YEARS ENDED JUNE 30, 2011 AND 2010

(Unaudited)

Operating expenses, which consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative decreased by .45% to \$85.2 million.

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

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

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2011, the Authority had invested approximately \$66.7 million in capital assets (net of related depreciation) including transportation equipment, land and buildings and machinery and equipment used in the operations. At June 30, 2010, the Authority had invested approximately \$64.6 million in capital assets.

Major capital assets events during the years ended June 30, 2011 and 2010 include the acquisition and repairs of transportation equipment which were funded principally by capital contributions received.

Debt Administration

The Authority has an unsecured line of credit with a commercial bank in which the Authority may borrow up to \$3,000,000. Outstanding balance bears interest at 1.25% over LIBOR.

In addition a long-term note payable with the same commercial bank payable in monthly principal installment of \$143,334 plus a fixed interest rate of 5.43% plus a spread as defined in the loan agreement. A balloon payment for the principal amount outstanding is due on February 2012. Management is in the process of negotiating a refinancing of this debt on a long-term basis with the bank. However since no final agreement has being reached with the bank, the balance outstanding at June 30, 2011 has being classified as a current liability.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

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

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

STATEMENTS OF NET ASSETS
 JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 4,290,692	\$ 625,576
Accounts receivable	8,217,231	23,962,847
Inventory	3,320,356	3,868,099
Prepaid expenses	<u>2,280,575</u>	<u>2,761,170</u>
Total current assets	18,108,854	31,217,692
Capital assets, net of accumulated depreciation	66,708,273	64,555,810
Other assets	<u>542,071</u>	<u>542,071</u>
Total assets	<u>\$ 85,359,198</u>	<u>\$ 96,315,573</u>
Liabilities		
Current liabilities		
Borrowings under line of credit	\$ 3,000,000	\$ 3,000,000
Accounts and accrued expenses payable	51,977,074	66,420,787
Deferred revenue	2,238,354	2,239,154
Current portion of long-term debt	<u>35,833,300</u>	<u>1,720,008</u>
Total current liabilities	<u>93,048,728</u>	<u>73,379,949</u>
Long-term debt'		
Notes payable, net of current portion	-	35,689,966
Voluntary termination and other related employee benefits	<u>3,824,836</u>	<u>-</u>
Total long-term debt	<u>3,824,836</u>	<u>35,689,966</u>
Net assets (deficit)		
Invested in capital assets, net of related debt	58,447,055	47,417,211
Unrestricted deficit	<u>(69,961,421)</u>	<u>(60,171,553)</u>
Net assets (deficit)	<u>(11,514,366)</u>	<u>(12,754,342)</u>
Total liabilities and net assets (deficit)	<u>\$ 85,359,198</u>	<u>\$ 96,315,573</u>

The accompanying notes are integral part of the financial statements

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Operating revenues		
Passenger fares	\$ 9,019,512	\$ 5,815,007
Advertising and other	229,034	498,095
Total operating revenues	<u>9,248,546</u>	<u>6,313,102</u>
Operating expenses		
Salaries and employee benefits, including voluntary termination benefits of \$4,936,000 in 2011	61,522,779	59,759,351
Diesel, gasoline, oil and lubricants	5,983,830	5,407,602
Depreciation and amortization	10,787,375	10,030,500
Materials, spare parts and repairs and maintenance	3,196,128	3,433,832
Utilities	1,347,819	1,354,164
Professional services	2,106,755	1,631,423
General and administrative	3,803,193	3,537,004
Total operating expenses	<u>88,747,879</u>	<u>85,153,876</u>
Operating loss	<u>(79,499,333)</u>	<u>(78,840,774)</u>
Non-operating revenues (expenses)		
Gasoline, diesel, petroleum and tax oil revenues	10,335,595	10,029,234
Operating grants:		
Commonwealth of Puerto Rico operating grant	53,931,722	42,616,745
Federal Transit Administration	9,546,393	14,306,520
Interest and other financing expenses	(5,167,416)	(4,132,395)
Interest income	1,158	494
Total non-operating revenues	<u>68,647,452</u>	<u>62,820,598</u>
Loss before capital contributions	(10,851,881)	(16,020,176)
Capital contributions	<u>12,181,857</u>	<u>22,833,564</u>
Change in net assets	1,329,976	6,813,388
Net asset deficiency		
Beginning of year	(12,754,342)	(19,567,730)
End of year	<u>\$ (11,424,366)</u>	<u>\$ (12,754,342)</u>

The accompanying notes are integral part of the financial statements

PUERTO RICO METROPOLITAN BUS AUTHORITY
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STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash received from customers and users	\$ 6,786,004	\$ 6,220,673
Cash payments to suppliers for goods and services	(13,011,802)	(11,703,486)
Cash payments to employees for services	(58,520,505)	(53,538,672)
Net cash used in operating activities	<u>(64,746,303)</u>	<u>(59,021,485)</u>
Cash flows from Non-capital financing activities:		
Operating grants received from:		
U.S. Federal Transit Administration	10,506,914	12,136,872
Commonwealth of Puerto Rico	64,285,555	51,520,183
Interest paid	(4,047,553)	(3,226,589)
Payment of notes payable	(1,576,674)	(1,720,008)
Net cash provided by non-capital financing activities	<u>69,168,242</u>	<u>58,710,458</u>
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(30,078,437)	(5,928,538)
Capital contributions	29,320,456	5,694,965
Net cash used by capital and related financing activities	<u>(757,981)</u>	<u>(233,573)</u>
Investing activities:		
Interest received	<u>1,158</u>	<u>494</u>
Net increase (decrease) in cash and cash equivalents	3,665,116	(544,106)
Cash and cash equivalents:		
Beginning of year	625,576	1,169,682
End of year	<u>\$ 4,290,692</u>	<u>\$ 625,576</u>

The accompanying notes are integral part of the financial statements

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

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2011 AND 2010

	<u>2011</u>	<u>2010</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (79,499,333)	\$ (78,840,774)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	10,787,375	10,030,500
Changes in operating assets and liabilities:		
Accounts receivable	(2,462,542)	(92,429)
Inventory	547,743	(196,249)
Prepaid expenses	480,595	(306,817)
Other assets	-	(275,000)
Accounts and accrued expenses payable	1,575,023	10,659,284
Voluntary termination benefits long-term	3,824,836	-
Net cash used in operating activities	<u>\$ (64,746,303)</u>	<u>\$ (59,021,485)</u>
Schedule of non-cash transactions:		
Accounts payable incurred in the acquisition of capital assets	<u>\$ 2,541,941</u>	<u>\$ 17,138,599</u>

The accompanying notes are integral part of the financial statements

PUERTO RICO METROPOLITAN BUS AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2011 AND 2010

1. Organization and Summary of Significant Accounting Policies

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

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

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

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

Measurement Focus and Basis of Accounting

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

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Use of Estimates

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

Cash and Cash Equivalents

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

Allowance for Doubtful Accounts

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

Inventories

Inventories, consisting of fuel, spare parts, materials and supplies are valued at the lower of cost (first-in, first-out method) or market.

Capital Assets

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

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The estimated useful lives of the capital assets follow:

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

The Authority periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. No impairment of capital asset was identified during the years ended June 30, 2011 and 2010.

Vacation and Sick Leave

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

Net assets

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

Invested in Capital Assets, Net of Related Debt

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

Unrestricted

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

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Operating Revenues and Expenses

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

Contributions

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

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

Risk Financing

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

Accrual for legal claims

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

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Recently Adopted GASB Statements

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

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

Recently Statements Issued by GASB

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

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

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The GASB has also issued Statement No. 61, The Financial Reporting Entity: Omnibus – An Amendment of GASB Statements Nos. 14 and 34 which is effective for fiscal years beginning after December 31, 2011. The requirements of this Statement result in financial reporting entity financial statements being more relevant by improving guidance for including, presenting and disclosing information about component units and equity interest transactions of a financial reporting entity. The Authority has not yet determined the effect, if any, that the adoption of GASB 61 may have on its financial statements.

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

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

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

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Reclassifications

Certain reclassifications were made to last year financial statements to conform with current year presentation.

2. Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2011 and 2010 consist of cash on hand and on bank deposit.

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

Pursuant to the Investment Guidelines for the Commonwealth adopted by Government Development Bank for Puerto Rico ("GDB"), the Authority may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, repurchase agreements, bankers acceptances, or in pools of obligations of the municipalities of Puerto Rico, among others. There are no investments at June 30, 2011 and 2010.

For deposits, custodial credit risk is the risk that in the event of bank failure, the Authority's deposits may not be returned to it. Under Puerto Rico statutes public funds deposited in commercial bank must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth of Puerto Rico. The bank balance of the Authority's deposit at June 30, 2011 and 2010, excluding deposits in Government Development Bank for Puerto Rico described below, amounted to approximately \$3,559,123 and \$1,345,815, respectively, of which \$1,341,993 and \$983,852 are insured by Federal Deposit Insurance Corporation at June 30, 2011 and 2010 respectively.

In addition, at June 30, 2011 and 2010, the Authority maintained cash deposited at the Governmental Development Bank for Puerto Rico (GDB), in the amount approximately \$2,644,066 and \$92,519, respectively. These amounts are uncollateralized since by law, the governmental banks of the Commonwealth of Puerto Rico are exempt of the requirement of insuring the deposits of funds of the entities of the Commonwealth of Puerto Rico.

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3. Accounts Receivable

Accounts receivable at June 30, 2011 and 2010 consist of:

	<u>2011</u>	<u>2010</u>
Operating and capital grants:		
U.S. Federal Transit Administration	\$ 2,728,309	\$ 20,918,229
Commonwealth of Puerto Rico	1,304,663	1,322,901
Puerto Rico Highways and Transportation Authority	4,688,122	1,575,930
Other	542,836	528,809
Total	<u>9,263,930</u>	<u>24,345,869</u>
Less allowance for doubtful accounts	1,046,699	383,022
Total	<u>\$ 8,217,231</u>	<u>\$ 23,962,847</u>

Account receivable from U.S Federal Transit Administration (“FTA”) consists principally of operating and capital contributions pending to be received at June 30, 2011 and 2010. At June 30, 2010 the amount receivable includes approximately \$17 million for capital contributions that are restricted for the payment of liabilities related to the acquisition of capital assets.

The account receivable from the Puerto Rico Highways and Transportation Authority (PRTHA) includes approximately \$4,368,200 and \$1,256,000 at June 30, 2011 and 2010 respectively related to a contract with PRTHA in which the Authority provides transportation services to passengers using the urban train system. Under the term of the contract PRTHA will reimburse the Authority certain amounts specified in the contract for each passenger served. The amount outstanding represents the amount billed to PRTHA for services performed since July 2005 to June 30, 2011. At June 30, 2011 management is in the process of discussing the amounts billed with PRTHA in order to settle the amount outstanding. Management believes that the amount outstanding represents billings for services performed under the term of the contract and that the amount will be collected.

During the year ended June 30, 2011 the Authority recognized operating revenues in the amount of \$4,451,768 which includes amount billed under the term of the contract with PRTHA for the year ended June 30, 2011 plus prior years unrecorded billings which were deemed doubtful of collection in prior years.

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4. Inventory

Inventory at June 30, 2011 and 2010 consists of:

	<u>2011</u>	<u>2010</u>
Spare parts	\$ 2,958,168	\$ 3,542,389
Diesel and gasoline	269,793	206,806
Supplies	92,395	118,904
Total	<u>\$ 3,320,356</u>	<u>\$ 3,868,099</u>

5. Accounts and Accrued Expenses Payable

Accounts payable and accrued expenses payable at June 30, 2011 and 2010 consist of:

	<u>2011</u>	<u>2010</u>
Suppliers	\$ 10,978,843	\$ 26,728,278
Excess of checks issued over bank balance	1,066,220	465,353
Agencies and public corporations of the Commonwealth of Puerto Rico	25,989,729	25,438,259
Compensated absences and other related benefits	7,864,238	7,596,912
Payroll taxes and withholdings	1,040,819	1,921,398
Voluntary termination and other related employee benefits	564,313	-
Legal claims	4,270,587	4,270,587
Accrued interest	202,325	-
Total	<u>\$ 51,977,074</u>	<u>\$ 66,420,787</u>

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

At June 30, 2010 accounts payable to suppliers include approximately \$17 million payable to a suppliers for the acquisition of certain transportation equipment. This amount will be paid from capital contributions from FTA. See Note 3.

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6. Capital Assets

The following schedule summarizes the capital assets held by the Authority as of June 30, 2011 and 2010:

	<u>Balance at June 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2011</u>
Assets not being depreciated:				
Land and improvements	\$ 2,569,210	\$ -	\$ -	\$ 2,569,210
Construction in process	-	5,750,281	-	5,750,281
Capital assets not being depreciated	<u>2,569,210</u>	<u>5,750,281</u>	<u>-</u>	<u>8,319,491</u>
Assets being depreciated:				
Buildings and improvements	17,869,096	399,997		18,269,093
Terminals	4,100,692			4,100,692
Transportation equipment	89,103,088	5,282,963	(4,002,882)	90,383,169
Machinery and equipment	<u>41,005,751</u>	<u>1,508,593</u>	<u>(184,322)</u>	<u>42,330,022</u>
Total	152,078,627	7,191,553	(4,187,204)	155,082,976
Less accumulated depreciation	<u>90,092,027</u>	<u>10,787,371</u>	<u>(4,185,204)</u>	<u>96,694,194</u>
Capital assets being depreciated, net	<u>61,986,600</u>	<u>(3,595,818)</u>	<u>(2,000)</u>	<u>58,388,782</u>
Total capital assets, net	<u>\$ 64,555,810</u>	<u>\$ 2,154,463</u>	<u>\$ (2,000)</u>	<u>\$ 66,708,273</u>
	<u>Balance at June 30, 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2010</u>
Assets not being depreciated:				
Land and improvements	\$ 2,569,210	\$ -	\$ -	\$ 2,569,210
Assets being depreciated:				
Buildings and improvements	17,869,096			17,869,096
Terminals	4,100,692			4,100,692
Transportation equipment	76,665,568	19,107,047	(6,669,527)	89,103,088
Machinery and equipment	<u>37,847,948</u>	<u>4,026,983</u>	<u>(869,180)</u>	<u>41,005,751</u>
Total	136,483,304	23,134,030	(7,538,707)	152,078,627
Less accumulated depreciation	<u>87,533,341</u>	<u>10,030,500</u>	<u>(7,471,814)</u>	<u>90,092,027</u>
Capital assets being depreciated, net	<u>48,949,963</u>	<u>13,103,530</u>	<u>(66,893)</u>	<u>61,986,600</u>
Total capital assets, net	<u>\$ 51,519,173</u>	<u>\$ 13,103,530</u>	<u>\$ (66,893)</u>	<u>\$ 64,555,810</u>

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7. Borrowings under Line of Credit

The Authority has an unsecured line of credit with a commercial bank in which the Authority may borrow up to \$3,000,000. Borrowings under this of line of credit are by the assignment of diesel tax revenues and bear interest at LIBOR plus a spread as defined in the agreement (1.5106% and 1.597% at June 30, 2011 and 2010, respectively).

A summary of the activity in the line of credit during the years ended June 30, 2011 and 2010 follows:

	<u>Balance at 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2011</u>	<u>Current Portion</u>
Borrowings under line of credit	\$ 3,000,000	\$ -	\$ -	\$ 3,000,000	\$ 3,000,000
	<u>Balance at 2009</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2010</u>	<u>Current Portion</u>
Borrowings under line of credit	\$ 3,000,000	\$ -	\$ -	\$ 3,000,000	\$ 3,000,000

8. Long-Term Debt

Long-term debt at June 30, 2011 and 2010 consist of:

	<u>Balance at 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2011</u>	<u>Current Portion</u>
Secured note payable to bank	\$ 37,409,974	\$ -	\$ (1,576,674)	\$ 35,833,300	\$ 35,833,300
	<u>Balance at 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2009</u>	<u>Current Portion</u>
Secured note payable to bank	\$ 39,129,982	\$ -	\$ (1,720,008)	\$ 37,409,974	\$ 1,720,000

The note payable to bank is secured by the assignment of diesel tax revenues and is payable in monthly principal installments of approximately \$144,000 plus interest at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2011 and 2010).

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The note is due on February 2012. Management is in the process of negotiating a refinancing of this debt on a long-term basis with the bank. However since no final agreement has being reached with the bank, the balance outstanding at June 30, 2011 has being classified as a current liability.

9. Retirement Plan

Substantially all the Authority's employees participate in the Retirement System of the Commonwealth of Puerto Rico ("the System"), a cost sharing multi-employer defined benefit pension plan. The payroll for employees covered by the System for the years ended June 30, 2011 and 2010 was approximately \$30 million and \$34.8 million, respectively.

All Authority's employees, who at the time of employment are 55 years old or less, are eligible to participate in the System. Employees who retire at or after age 55 with 25 years of credited service or age 58 with 10 years of credited service are entitled to a retirement benefit, payable each month for life, computed based on a benefit rate set forth by Commonwealth statute.

The System also provides death and disability benefits established by Commonwealth statute. Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Authority is required by the same statute to contribute 9.275% of the participant's gross salary.

On September 24, 1999, an amendment to Act No. 447 of May 1, 1951, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Employees joining the Authority on or after January 1, 2001, will only be allowed to become members of System 2000. System 2000 will reduce the retirement age from 65 years to 60 for those employees who joined the current plan on or after April 1, 1990.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there will be a pool of pension assets, which will be invested by the System, together with those of the current defined benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity will be based on a formula which takes into account each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) and investment income as defined in the Plan. Participants will receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions will not be granted under System 2000.

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Total employer contributions during the years ended June 30, 2010 and 2009 under this plan amounted to approximately \$2,776,000 and \$2,885,000 respectively.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2011 and 2010, a copy of which can be obtained from the Retirement System Administration, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

10. Commitments and Contingent Liabilities

Litigation

The Authority is involved in litigation arising in the normal course of operations. Management believes that its ultimate liability, if any, in connection with these matters will not have a material effect on the Authority's financial condition and results of operations. Due to uncertainties in the settlement process, it is at least reasonably possible that management's view of the outcome of these claims will change in the near term. Based on advice of legal counsel, management has recorded an estimated litigation and claim loss of approximately \$4,270,000 as of June 30, 2011 and 2010.

Federal Assistance Programs

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

11. Voluntary Termination Benefits

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

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

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

The financial impact resulting for the benefits granted to participants on this program was the recognition within the Authority's financial statements of a liability of approximately \$3,972,000 in the statement of net assets as of June 30, 2011 and a charge of \$4,936,000 in the statement of activities for the year ended June 30, 2011. At June 30, 2011, unpaid long-term benefits granted on this program were discounted at 2.99%.

12. Operating Financial Assistance from the Commonwealth Of Puerto Rico

As shown in the accompanying financial statements, the Authority has incurred in accumulated losses after operating and capital contributions in the amount of \$70 million and as of June 30, 2011 the Authority's liabilities exceeded its assets by approximately \$11.5 million. In addition, at June 30, 2011 the Authority has a working capital deficiency of approximately \$74.9 million making it difficult for the Authority to pay its liabilities in the normal course of business. These facts indicate that the Authority needs the continued support from the Commonwealth of Puerto Rico in the form of operating grants to continue to operate at its present level and to continue as a going concern. The Commonwealth of Puerto Rico has experienced budget constrains during the current and prior years which have resulted in reductions in the operating grants provided to the Authority. Management believes that since the transportation service provided by the Authority is an essential service to the people of Puerto Rico, the Commonwealth of Puerto Rico will continue to fund the operational deficits incurred by the Authority. Any significant reduction in these operating grants and financial support will affect the ability of the Authority to provide the transportation services and to continue as a going concern.