

NATIONAL PARKS COMPANY OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

BASIC FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2012

(WITH INDEPENDENT AUDITOR'S REPORT THEREON)

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

Board of Directors
National Parks Company of Puerto Rico
San Juan, Puerto Rico

We have audited the accompanying financial statements of the National Parks Company of Puerto Rico (from now NPC), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2012 and for the year then ended, as listed in the accompanying table of contents. These financial statements are the responsibility of NPC's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, all material respects, the financial position of NPC as of June 30, 2012 and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 6 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.

Torres, Hernández & Punter, CPA, PSC
Certified Public Accountants

September 26, 2012

Stamp #E23236 of the
College of CPA's of
Puerto Rico is affixed
to the original.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the National Parks Company of Puerto Rico (from now on NPC) financial performance provides an overview of the NPC's financial activities for the fiscal year ended June 30, 2012. Please read it in conjunction with NPC's audited basic financial statements, beginning on page 7.

FINANCIAL HIGHLIGHTS:

- Capital grants, contributions and governmental appropriations decreased by approximately \$4.1 millions,
- Charges from services for the operation of recreational facilities and park activities decreased by \$690,092,
- Total operating expenses decreased by \$9.1 millions, and
- Total assets decreased by approximately \$23 millions due principally to the transfer of the Laguna del Condado and Tercer Mileneo Park to the Municipality of San Juan, which had a book value of \$9,996,728.

USING THE ANNUAL REPORT:

This annual report consists of a series of basic financial statements. The Statement of Net Assets, the Statements of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows provide information about the activities of NPC's as a whole and present a view of NPC finances. These statements show how these services were financed in the short-term as well as what remains for future activities.

OVERVIEW OF THE FINANCIAL STATEMENTS:

NPC is a component unit of the Commonwealth of Puerto Rico and is presented in the Commonwealth's government wide financial statements as an enterprise fund.

Government-wide statements, consist of a statement of net assets and a statement of activities prepared using the economic resources measurement focus and accrual basis of accounting. These statements will report all the assets, liabilities, revenues, and expenses of the government. Each statement will distinguish between the governmental and business-type activities of the primary government and between the total primary government and its discretely presented component units by reporting each in separate columns. Fiduciary activities, whose resources are not available to finance the government's programs, will be excluded from the government-wide statements.

An enterprise fund essentially encompasses the same functions reported as business-type activities in the government-wide statements. Substantially all services are provided to customers not related to the Commonwealth of Puerto Rico.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED):

OVERVIEW OF THE FINANCIAL STATEMENTS (CONTINUED):

NPC's basic financial statements are presented attached to this document and are accompanied by notes to the basic financial statements, which provide information essential to their full understanding.

Statement of Net Assets:

The Statement of Net Assets presents NPC's statement of position as of June 30, 2012 and 2011, showing information that includes all of NPC's assets and liabilities, as well as the net assets.

Statement of Revenues, Expenses and Changes in Net Assets:

The statement of revenues, expenses and changes in net assets shows how the NPC's net assets changed during the fiscal year. All current fiscal year revenues and expenses are included regardless of when cash is received or paid. An important purpose of the design of this statement is to show the financial reliance of NPC's functions on revenues earned.

Statement of Cash Flows:

The statement of cash flows presents the sources and uses of cash flows divided in four categories: operating activities, non-capital financing activities, capital and related financing activities and investing activities. The statement reconciles net cash and cash equivalents at the beginning and end of year and reconciles the net income (loss) with the cash used in operating activities to provide an explanation of cash and non-cash activities within the statement of revenues, expenses and changes in net assets.

FINANCIAL ANALYSIS OF NPC AS A WHOLE:

NPC is a public Company and a governmental instrumentality of the Commonwealth of Puerto Rico, created by law No. 10 on April 8, 2001 as a result of a combination of two agencies, the Recreational Development Company of Puerto Rico, created by law No. 114 on 1961 as amended, and the Trust for the Conservation, Operation and Maintenance of Puerto Rico National Parks constituted by Public Deed No. 3 on December 1988.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED):

Our analysis shown below focuses on net assets (Table 1) and change in net assets (Table 2) for NPC's activities compared to prior year:

TABLE - 1 STATEMENT OF NET ASSETS

	<u>June 30,</u>		
	<u>2012</u>	<u>2011</u>	<u>Total % Change</u>
Assets:			
Current Assets	\$ 2,017,077	\$ 4,591,818	(0.56)%
Restricted Assets	17,000,047	22,473,233	(0.24)%
Capital Assets - Net	<u>166,185,004</u>	<u>180,942,413</u>	<u>(0.08)%</u>
Total Assets	<u>\$185,202,128</u>	<u>\$208,007,464</u>	<u>(0.11)%</u>
Liabilities:			
Current Liabilities	\$ 32,747,460	\$ 33,417,535	(0.02)%
Long-Term Debts	<u>19,405,526</u>	<u>18,930,603</u>	<u>0.03 %</u>
Total Liabilities	<u>52,152,986</u>	<u>52,348,138</u>	<u>- %</u>
Net Assets:			
Invested in Capital Assets, Net of Debt	160,291,130	174,979,434	(0.08)%
Restricted	16,652,422	22,347,982	(0.25)%
Unrestricted	<u>(43,894,410)</u>	<u>(41,668,090)</u>	<u>0.05 %</u>
Total Net Assets	<u>133,049,142</u>	<u>155,659,326</u>	<u>(0.15)%</u>
Total Liabilities and Net Assets	<u>\$185,202,128</u>	<u>\$208,007,464</u>	<u>(0.11)%</u>

As observed from the table above, NPC's net assets decrease from \$208,007,464 to \$185,202,128 , for a total decrease of \$ 22,805,336 or 11%. The decrease in net assets was primarily due to the net effect of decrease in net capital assets. During 2012 net capital assets decreased mostly by a transfer of "Laguna del Condado" and "Tercer Mileneo Park" facilities and operations to the Municipality of San Juan, with a net book value of \$9,996,728.00.

Restricted assets decreased by \$ 5,695,560 or 25%, due to deposit certificates cancellations, for which monies were used by NPC for payment of capital improvements.

Total liabilities of the NPC decreased by \$ (195,152) or 2%.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED):**TABLE 2 - REVENUES, EXPENSES AND CHANGE IN NET ASSETS**

	<u>June 30,</u>		
	<u>2012</u>	<u>2011</u>	<u>Total % Change</u>
Operating Revenues			
Charges for Services	\$ <u>9,129,118</u>	\$ <u>9,819,210</u>	<u>(0.07)%</u>
Total Operating Revenues	<u>9,129,118</u>	<u>9,819,210</u>	<u>(0.07)%</u>
Operating Expenses			
Salaries and Fringe Benefits	24,390,098	21,796,265	0.12 %
Employee Future Benefits	1,139,483	10,930,388	(0.90)%
Depreciation and Amortization	6,628,772	7,336,201	(0.90)%
Utilities	3,225,896	4,188,195	(0.23)%
Security	2,014,434	1,940,585	0.04 %
Other Expenses	<u>7,033,878</u>	<u>7,413,141</u>	<u>(0.05)%</u>
Total Operating Expenses	<u>44,432,561</u>	<u>53,604,775</u>	<u>(0.17)%</u>
Operating Loss before Non-Operating Revenues (Expenses)	<u>(35,303,443)</u>	<u>(43,785,565)</u>	<u>(0.19)%</u>
Non-Operating Revenues (Expenses) and Capital Contributions/Transfers			
Interest Income	117,077	282,613	(0.59)%
Interest Expense	(426,266)	(451,677)	(0.06)%
Sale of Land	632,000	1,304,100	- %
Other Income	55,382	67,049	- %
Capital Grants and Contributions	243,373	732,021	(0.67)%
Capital Contributions from the Commonwealth of Puerto Rico	21,857,081	25,981,916	(0.16)%
Transfer Out Capital Assets	<u>(9,996,728)</u>	<u>(13,541,016)</u>	<u>- %</u>
Total Non-Operating Revenues (Expenses) - Net	<u>12,481,919</u>	<u>14,375,006</u>	<u>(0.13)%</u>
Change in Net Assets	<u>(22,821,524)</u>	<u>(29,410,559)</u>	<u>(0.22)%</u>
Net Assets, Beginning of Year, as Previously Presented	155,659,326	187,657,364	(0.17)%
Restatement of Net Assets	<u>211,340</u>	<u>(2,587,479)</u>	<u>- %</u>
Net Assets, Beginning of Year, as Adjusted	<u>155,870,666</u>	<u>185,069,885</u>	<u>(0.16)%</u>
Net Assets, End of Year	\$ <u>133,049,142</u>	\$ <u>155,659,326</u>	<u>(0.15)%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED):

As observed from table in previous page, capital contributions from the Commonwealth of Puerto Rico decreased by 16%, because during 2011 NPC received \$5,924,284 to cover payment of two accrued lawsuits, which were not received during 2012.

CAPITAL ASSETS AND DEBT ADMINISTRATION:

Capital assets:

At the end of the year June 30, 2012, NPC had approximately \$266 millions invested in total capital assets including land, buildings, parks, construction in progress, machinery, furniture and fixtures, computers and software, animals and automobiles. Accumulated depreciation amounted to \$99 millions, for a net capital assets balance of \$166 millions. This represents a net decrease of \$15 million, over the last year. The reduction was due to transfers of "Laguna del Condado" and "Tercer Mileneo Park" facilities and operations to the Municipality of San Juan.

Debt

As of June 30, 2012 NPC had an outstanding balance of approximately \$12.4 millions, including accrued interests, corresponding to three non-rotating credit lines of credit agreements with the Puerto Rico Governmental Development Bank (GDB). Credit lines are supported by legislative resolutions with certain restrictive covenants. Detailed information about these credit lines is presented in Note 5 to the basic financial statements.

Contingencies

NPC is a defendant in various lawsuits. NPC and its internal and external legal representatives are of the opinion that It is not possible to predict as of financial statement date the outcome of those lawsuits. NPC has an accrued litigation liability of \$2,620,837.

CONTACTING THE ADMINISTRATION FINANCIAL MANAGEMENT

The financial report is designed to provide our citizens, taxpayers, customers, investors and creditors with a general overview of the NPC's finance and to show the NPC's accountability for the funds it receives. If you have questions about this report or need additional financial information, contact the Finance Director at (787) 622-5200.

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS
JUNE 30, 2012

ASSETS:**CURRENT ASSETS**

CASH AND CASH EQUIVALENTS	\$ 1,371,988
ACCOUNTS RECEIVABLE	622,163
PREPAID EXPENSES	<u>22,926</u>
TOTAL CURRENT ASSETS	<u>2,017,077</u>

NON-CURRENT ASSETS

RESTRICTED FUNDS:

CASH AND CASH EQUIVALENTS	17,000,047
CAPITAL ASSETS, NET	<u>166,185,004</u>
TOTAL NON-CURRENT ASSETS	<u>183,185,051</u>

TOTAL ASSETS \$ 185,202,128

See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF NET ASSETS (CONTINUED)
JUNE 30, 2012

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

EXCESS OF OUTSTANDING CHECKS OVER BANK BALANCE	\$ 41,516
SHORT-TERM NOTES	12,173,599
INTEREST PAYABLE	315,974
ACCRUED COMPENSATED ABSENCES	248,148
ACCOUNTS PAYABLE:	
TRADE	1,076,124
RETAINAGE	364,528
ACCRUED LIABILITIES	7,600
DEFERRED REVENUE	210,919
DUE TO OTHER GOVERNMENTAL ENTITIES	<u>18,309,052</u>
 TOTAL CURRENT LIABILITIES	 <u>32,747,460</u>

NON-CURRENT LIABILITIES

ACCRUED COMPENSATED ABSENCES	4,714,818
PENSION AND OTHER EMPLOYEE FUTURE BENEFITS	12,069,871
ACCRUED LITIGATIONS LIABILITY	<u>2,620,837</u>
 TOTAL NON-CURRENT LIABILITIES	 <u>19,405,526</u>
 TOTAL LIABILITIES	 <u>52,152,986</u>

COMMITMENTS AND CONTINGENCIES

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NET ASSETS

INVESTED IN CAPITAL ASSETS, NET OF RELATED DEBT	160,291,130
RESTRICTED FOR PROJECTS	16,652,422
UNRESTRICTED	<u>(43,894,410)</u>
 TOTAL NET ASSETS	 <u>133,049,142</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$ 185,202,128</u>

See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO**(A Component Unit of the Commonwealth of Puerto Rico)****STATEMENTS OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS****FOR THE YEAR ENDED JUNE 30, 2012****OPERATING REVENUES**

CHARGES FOR SERVICES	\$ <u>9,129,118</u>
TOTAL OPERATING REVENUES	<u>9,129,118</u>

OPERATING EXPENSES

SALARIES AND FRINGE BENEFITS	24,390,098
EMPLOYEE FUTURE BENEFITS	1,139,483
DEPRECIATION AND AMORTIZATION	6,628,772
WASTE DISPOSAL	109,946
RENT	71,125
REPAIRS AND MAINTENANCE	2,113,055
INSURANCE	917,033
PROFESSIONAL SERVICES	349,583
GENERAL AND ADMINISTRATIVE	2,332,433
UTILITIES	3,225,896
MATERIALS AND SUPPLIES	433,440
SECURITY	2,014,434
BANK CHARGES	118,966
AUTO EXPENSES	<u>588,297</u>
TOTAL OPERATING EXPENSES	<u>44,432,561</u>
OPERATING LOSS BEFORE NON- OPERATING REVENUES (EXPENSES)	<u>(35,303,443)</u>

NON-OPERATING REVENUES (EXPENSES)

INTEREST INCOME	117,077
INTEREST EXPENSE	(426,266)
SALE OF LAND	632,000
OTHER INCOME	<u>55,382</u>
TOTAL NON-OPERATING REVENUES (EXPENSES) - NET	<u>378,193</u>
LOSS BEFORE CONTRIBUTIONS AND TRANSFERS	\$ <u>(34,925,250)</u>

See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO**(A Component Unit of the Commonwealth of Puerto Rico)****STATEMENTS OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS (CONTINUED)****FOR THE YEAR ENDED JUNE 30, 2012****CAPITAL CONTRIBUTIONS AND TRANSFERS**

CAPITAL CONTRIBUTIONS FROM THE COMMONWEALTH OF PUERTO RICO	\$ 21,857,081
CAPITAL GRANTS AND CONTRIBUTIONS	243,373
TRANSFER OUT FACILITIES TO A MUNICIPALITY	<u>(9,996,728)</u>
TOTAL CAPITAL CONTRIBUTIONS AND TRANSFERS	<u>12,103,726</u>
CHANGE IN NET ASSETS	<u>(22,821,524)</u>
NET ASSETS, BEGINNING OF YEAR	155,659,326
RESTATEMENT OF NET ASSETS	<u>211,340</u>
NET ASSETS, BEGINNING OF YEAR, AS ADJUSTED	<u>155,870,666</u>
NET ASSETS, END OF YEAR	<u>\$ 133,049,142</u>

See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOW FROM OPERATING ACTIVITIES:

CASH RECEIVED FROM CHARGES FOR SERVICES	\$ 9,138,980
CASH PAID TO SUPPLIERS	(12,081,149)
CASH PAID FOR SALARIES AND FRINGE BENEFITS	<u>(24,937,552)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>(27,879,721)</u>

**CASH FLOW FROM NON-CAPITAL FINANCING
ACTIVITIES:**

CONTRIBUTIONS FROM THE GOVERNMENT OF THE COMMONWEALTH OF PUERTO RICO	<u>21,857,081</u>
NET CASH PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	<u>21,857,081</u>

**CASH FLOW FROM CAPITAL AND RELATED
FINANCING ACTIVITIES:**

PURCHASE OF PROPERTY AND EQUIPMENT, AND CONSTRUCTION OF PROPERTY	(1,868,091)
CAPITAL GRANTS AND CONTRIBUTIONS	454,292
PROCEEDS FROM CAPITAL ASSETS DISPOSITION	632,000
PAYMENTS OF CREDIT LINES AND OBLIGATIONS	(903,373)
OTHER INCOME	55,382
INTEREST PAID	<u>(426,266)</u>
NET CASH USED BY CAPITAL AND RELATED FINANCING ACTIVITIES	<u>(2,056,056)</u>

CASH FLOW FROM INVESTING ACTIVITIES:

INTEREST RECEIVED	117,077
NET INCREASE IN EXCESS OF OUTSTANDING CHECKS OVER CASH BALANCE	<u>41,516</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>158,593</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,920,103)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>26,292,138</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 18,372,035</u>

See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2012

**RECONCILIATION OF OPERATING LOSS TO
NET CASH USED IN OPERATING ACTIVITIES:**

OPERATING LOSS BEFORE NON-OPERATING REVENUES AND CONTRIBUTIONS	\$ (35,303,443)
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ADJUSTMENTS TO RECONCILE OPERATING LOSS TO
NET CASH USED IN OPERATING ACTIVITIES:

DEPRECIATION AND AMORTIZATION	6,628,772
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CHANGE IN ASSETS AND LIABILITIES:

DECREASE IN ACCOUNTS RECEIVABLE	9,862
DECREASE IN PREPAID EXPENSES	117,962
INCREASE IN ACCOUNTS PAYABLE	488,005
INCREASE IN PENSION AND OTHER EMPLOYEE FUTURE BENEFITS	1,139,483
INCREASE IN ACCOUNTS PAYABLE RETAINAGE	197,749
DECREASE IN ACCRUED COMPENSATED ABSENCES	(547,454)
INCREASE IN ACCRUED LITIGATIONS LIABILITIES	7,600
DECREASE IN DUE TO GOVERNMENTAL ENTITIES	<u>(618,257)</u>

NET CASH USED IN OPERATING ACTIVITIES	\$ <u>(27,879,721)</u>
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RECONCILIATION OF CASH AND CASH EQUIVALENTS
WITH THE STATEMENT OF NET ASSETS:

CASH IN CURRENT ASSETS	\$ 1,371,988
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CASH RESTRICTED - NON CURRENT ASSETS	<u>17,000,047</u>
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	\$ <u>18,372,035</u>
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NON-CASH CAPITAL TRANSACTIONS

During 2012 NPC made the following transactions:

Transferred to the Municipality of San Juan - Capital Assets Facilities (Net of Accumulated Depreciation)	\$ <u>9,996,728</u>
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See accompanying notes and auditor's report, which are an integral part of the Basic Financial Statements.

NATIONAL PARKS COMPANY OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2012

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND ACTIVITY

The National Parks Company of Puerto Rico (From now on NPC) is a public corporation and an instrumentality of the Commonwealth of Puerto Rico. NPC was created by Law No. 10 on April 8, 2001 as a result of a combination of two agencies, the Recreational Development Company of Puerto Rico created by Law No. 114 on 1961 as amended, and the Trust for the Conservation, Operation and Maintenance of Puerto Rico National Parks constituted by Public Deed No. 3 on December 1988.

NPC has the obligation of protecting, operating and providing maintenance and conservation of all national parks established at the moment and those to be created in the future.

During the year ended June 30, 2012, NPC expended less than \$500,000 in federal grants received.

FINANCIAL REPORTING ENTITY

The financial reporting entity included in this report consists of the basic financial statements of the NPC (primary government). To fairly present the financial position and the results of operations of the financial reporting entity management must determine whether its reporting entity consists of only the legal entity known as the primary government or one or more organizations called component units. The inclusion of a potential component unit in the primary government's reporting entity depends on whether the primary government is financially accountable for the potential component unit or on whether the nature and significance of the relationship with the primary government is such that exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete. There are two methods of presentation of the component unit in the basic financial statements: (a) blending the financial data of the component units' balances and transactions in a manner similar to the presentation of the Company's balances and (b) discrete presentation of the component unit's financial data in columns separate from the Company's balances and transactions.

The basic criteria for deciding financial accountability are any one of the following:

- Financial dependency of the potential component unit on the primary government, or
- The primary government appoint a voting majority of the potential component unit's governing body and,
 1. The primary government can impose its will on the potential component unit and/or,
 2. A financial benefit/burden exists between the primary government and the potential component unit.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**BASIS OF FINANCIAL STATEMENT PRESENTATION (CONTINUED)****FINANCIAL REPORTING ENTITY (CONTINUED)**

In addition, a legally separate, tax exempt organization should be discretely presented as a component unit of a reporting entity if all of the following criteria are met:

- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents.
- The primary government, or its component units, is entitled to, or has the ability to otherwise access a majority of the economic resources received or held by the separates organizations.
- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

Other organizations should be evaluated as potential component units if they are closely related to, or financially integrated with, the primary government. Professional judgment is applied in determining whether the relationship between a primary government and other organizations for which the primary government is not accountable and that do not meet these criteria is such that exclusion of the organization would render the financial statements of the reporting entity misleading or incomplete.

Based on the above criteria there are no potential component units which should be included as part of the basic financial statements.

BASIS OF FINANCIAL STATEMENT PRESENTATION**(A) METHOD OF ACCOUNTING FOR PROPRIETARY FUNDS**

NPC reports its financial position and results of operations as an enterprise fund. Financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Proprietary funds are used to account for business-type activities, which are financed mainly by fees and charges to users of the services provided by the funds operations. Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Pursuant to the Governmental Accounting Standards Board (GASB Statement) No. 20 "Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Accounting", NPC has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

(B) MANAGEMENT'S DISCUSSION AND ANALYSIS

This consist of a narrative introduction and analytical overview of NPC's financial activities. This analysis is similar to the analysis the private sector provides in their annual reports.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**BASIS OF FINANCIAL STATEMENT PRESENTATION (CONTINUED)****(C) USE OF ESTIMATES**

The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America (US 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 basic financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Where significant estimates have been made in preparing these financial statement, they are described in the applicable footnotes.

(D) STATEMENT OF CASH FLOWS

NPC prepares its statement of cash flows using the direct method. For the purpose of this statement NPC includes as cash equivalents all unrestricted and restricted highly liquid debt instruments with original maturities of three months or less at time of purchase.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies is presented to assist in understanding that the basic financial statements and notes are representations of management, who is responsible for their integrity and objectivity. These accounting policies conform to US GAAP.

(E) NON-EXCHANGE TRANSACTIONS

GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions" establishes accounting and financial reporting standards for nonexchange transactions involving financial or capital resources (for example, most taxes, grants, and private donations). In non-exchange transactions, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an exchange transaction, in which each party receives and gives up essentially equal values. Under the provisions of this statement, the provider and the recipient should recognize the non-exchange transaction as an expense and revenue, respectively, when all eligibility requirements are satisfied.

(F) SOURCES OF INCOME

Charges for services on the vacation centers are the main source of income of NPC and allow the operation of other installations where their activities are free of charge to the public. Collections of the vacation centers is invested in maintaining and improving the structures and operation of the installations of the NPC.

Other sources of revenues consist primarily of legislative appropriations from the Commonwealth of Puerto Rico, capital grants and contributions.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(G) ACCOUNTING FOR PENSION COSTS

NPC accounts for pension costs in accordance with provisions of GASB Statement No. 27, "Accounting for Pensions by States and Local Governmental Employers".

GASB Statement No. 27 establishes standards of accounting and financial reporting for pension expenditures/expenses and related pension liabilities, pension assets, note disclosures, and required supplementary information in the financial reports of state and local governmental employers. The statement defines that the pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between statutory required and actual contributions.

(H) RECEIVABLES AND ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is an amount that the NPC believes will be adequate to absorb possible losses on existing receivables that may become uncollectible based on evaluations of their collectibility. Because of uncertainties inherent in the estimation process, the NPC's estimates of losses in the receivables outstanding and the related allowance may change.

(I) CAPITAL ASSETS AND DEPRECIATION AND AMORTIZATION POLICY

Capital assets are stated at cost. The costs of normal maintenance and repairs that do not add to the asset's value or materially extend the asset's useful life are not capitalized. NPC defines capital assets as assets with an individual cost of more than \$100 and a useful life of three (3) years or more. Assets to be depreciated and amortized were assigned a residual value of between 5% to 10% of original cost. At the time capital assets are sold or otherwise disposed, the cost and related accumulated depreciation and amortization is removed from books and the resulting gain or loss, if any is credited or changed to operations.

Depreciation and amortization expense is computed using the straight-line method over the estimated useful lives of the respective assets, as follows:

<u>Description</u>	<u>Estimated Useful Lives</u>
Land	-
Construction in Progress	-
Building, Parks, Squares and Improvements	40
Machinery, Equipment and Others	5 - 15
Animals	15 - 70
Vehicles	5 - 15

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(J) ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS

NPC follows GASB Statement No. 42, "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries". This Statement establishes accounting and financial reporting standards for impairment of capital assets. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. This Statement also clarifies and establishes accounting requirements for insurance recoveries. During the year ended June 30, 2012, NPC evaluated its capital assets for impairment under the guidance of this Statement and determined that the possible impairment amount, if any, would not have a material impact in NPC's basic financial statements.

(K) COMPENSATED ABSENCES

NPC vacations policy generally provides for the accumulation of thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation time is fully vested to the employees from the first day of work. In the event of resignation, an employee is reimbursed for accumulated vacations days up to the maximum allowed of sixty (60) days.

Separation of employment prior to the use of all or part of the sick leave terminates all rights for compensation except that, in the event of retirement, an employee is reimbursed for accumulated sick leave days up to the maximum allowed of ninety (90) days. A liability is reported for accrued but unused vacation and sick leave days.

Compensated absences, such as unpaid vacation and sick leave pay, are accrued when incurred using the pay salary rates in effect at the Statement of Net Assets date. An additional amount is incurred for certain salary related benefits associated with the payment of compensated absences.

As per Law No. 156 of August 20, 1996, for fiscal years beginning on July 1, 1997, the employee has the right to accumulate the excess of 60 days of vacations and 90 days of sick leave until December 31st. of each year. The excess should be paid to the employee before March 31st. of the following year.

(L) NET ASSETS CLASSIFICATION

Net assets represent the difference between assets and liabilities and are presented in three components as follows:

- **Invested in capital assets, net of related debts** - consist of capital assets net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or borrowings that are attributable to the acquisition, construction, or improvements of those assets.

Net assets invested in capital assets, net of related debt, is composed of the following:

Capital Assets, Net of Accumulated Depreciation	\$ 166,185,004
Oustanding Balance on Related Debt	<u>(5,893,874)</u>
Total Invested in Capital Assets, Net of Related Debt	<u>\$ 160,291,130</u>

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**(L) NET ASSETS CLASSIFICATION (CONTINUED)**

- **Restricted net assets** - consist of net assets with constraint placed on the use either by: (1) external groups such as creditors, grantors, contributions, or law or regulations of other government; (2) law through constitutional provisions or enabling legislation.
- **Unrestricted net assets** - consist of all other assets that do not meet the definitions of "restricted" or "invested in capital assets, net of related debts".

(M) RISK MANAGEMENT

NPC is exposed to various risks of loss from torts, theft of, damage to, and destruction of assets, errors and omissions, claims from employee injuries and illnesses, natural disasters, environmental and other losses. Commercial insurance coverage, obtained for claims arising from such matters, is negotiated by the Treasury Department of the Commonwealth of Puerto Rico, and the cost is paid by NPC.

(N) RESTRICTED ASSETS

Funds set aside mainly for improvements of capital assets are classified as restricted assets since their use is limited for this purpose by applicable agreements or required by law.

(O) FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS

The Governmental Accounting Standards Board (GASB) issued the following pronouncements that have effective dates after June 30, 2012:

GASB Statement No. 60, "Accounting and Financial Reporting for Service Concession Arrangements". The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.

This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

GASB Statement No. 61, "The Financial Reporting Entity: Omnibus - an amendment of GASB Statements No. 14 and No. 34". The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, "The Financial Reporting Entity", and the related financial reporting requirements of Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments", were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

(O) FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting. This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

GASB Statement No. 62, "Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements". The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement also supersedes Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

GASB Statement No. 63, "Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position". This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, Elements of Financial Statements, introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for

(O) FUTURE ADOPTION OF ACCOUNTING PRONOUNCEMENTS (CONTINUED)

State and Local Governments, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

NPC's financial statements as of June 30, 2012 were not affected by these statements.

NOTE 2 - CUSTODIAL CREDIT RISK - DEPOSITS

The information presented below discloses the level of custodial credit risk assumed by the NPC as of June 30, 2012. Custodial credit risk is the risk that in the event of a financial institution failure, NPC's deposits may not be returned to it.

The Commonwealth of Puerto Rico requires that public funds deposited in commercial banks in Puerto Rico 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 Puerto Rico. Funds deposited with the Puerto Rico Governmental Development Bank (GDB) and the Economic Development Bank (EDB), components units of the Commonwealth of Puerto Rico, are not covered by this requirement.

NPC follows GDB's policies for deposits placed with banks, which establish maximum exposure limits for each institution based on the institution's capital, financial condition and credit rating assigned by nationally recognized rating agencies.

As of June 30, 2012, NPC had cash deposits with GDB with a bank balance of approximately \$19 millions, which are unsecured and uncollateralized. The depository commercial bank balances as June 30, 2012 amounted to approximately \$7 millions. The deposits in GDB are exempt from the collateral requirements established by the Commonwealth. In addition, deposits placed with government banks include certificate of deposits and banks accounts amounting to approximately \$12 million.

The following summarizes cash and cash equivalents as of June 30, 2012:

(A) Unrestricted Cash and Equivalents

Cash	\$ 1,371,988
Excess of Outstanding Checks Over Bank Balance	<u>(41,516)</u>
	<u>\$ 1,330,472</u>

(B) Restricted Cash

Cash in Banks	\$ 347,625
Certificates of Deposit	<u>16,652,422</u>
	<u>\$ 17,000,047</u>

NOTE 3 - ACCOUNTS RECEIVABLE

As of June 30, 2012 accounts receivable consisted of the following:

Governmental Agencies	\$ 173,606
Municipalities	57,102
Other - Private Companies	<u>391,455</u>
Accounts Receivable - Net	<u>\$ 622,163</u>

NOTE 4 - CAPITAL ASSETS

As of June 30, 2012 major classes of capital assets consisted of the following:

	<u>2011</u>	<u>Additions and Reclassifications</u>	<u>Retirements and Reclassifications</u>	<u>2012</u>
Being Depreciated:				
Buildings and Parks	\$ 186,069,766	\$ -	\$ (3,349,670)	\$ 182,720,096
Building Improvements	58,026,832	610,430	(8,993,045)	49,644,217
Machinery and Equipment	6,701,959	111,609	-	6,813,568
Motor Vehicles	5,808,755	470,048	-	6,278,803
Animals	<u>726,995</u>	<u>6,408</u>	<u>-</u>	<u>733,403</u>
	<u>257,334,307</u>	<u>1,198,495</u>	<u>(12,342,715)</u>	<u>246,190,087</u>
Less Accumulated Depreciation and Amortization	<u>(95,539,717)</u>	<u>(6,628,772)</u>	<u>2,345,987</u>	<u>(99,822,502)</u>
	<u>161,794,590</u>	<u>(5,430,277)</u>	<u>(9,996,728)</u>	<u>146,367,585</u>
Not Depreciated:				
Land	18,557,801	-	-	18,557,801
Construction in Progress	<u>590,022</u>	<u>669,596</u>	<u>-</u>	<u>1,259,618</u>
	<u>19,147,823</u>	<u>669,596</u>	<u>-</u>	<u>19,817,419</u>
Capital Assets, Net	<u>\$ 180,942,413</u>	<u>\$ (4,760,681)</u>	<u>\$ (9,996,728)</u>	<u>\$ 166,185,004</u>

NOTE 5 - SHORT - TERM NOTES

As of June 30, 2012 NPC has three credit line agreements with Governmental Development Bank (GDB) as follows:

- On August 17, 2007, NPC entered in a \$10 million credit line agreement with GDB in order to finance an early retirement program in response to the Act No. 70 of June 30, 2007. Borrowings under this credit line agreement bear interest at a fixed rate of 7%. The principal and accrued interest are payable on October 31 of each year until December 31, 2018, the maturity date of the line. The source for the repayment of the principal and interest comes from the revenues collected by NPC during the first four months of the year and will be

NOTE 5 - SHORT - TERM NOTES (CONTINUED)

approximately \$1,304,000 from 2010-2011 and thereafter until 2018. As part of the agreement, NPC also transferred two land lots to GDB for the amortization of this debt. The land lots were sold during 2008 and 2012 and the proceeds of the sales were applied to the balance of debt. As of June 30, 2012 this line of credit amounted to \$6,279,724.

- On February 6, 2003, NPC entered into a \$9,287,428 credit line agreement with GDB in order to finance the improvements to certain parks, seaside facilities and building of NPC. Borrowings under this line of credit bear interest at variable rates (7% as of June 30, 2012). The principal and interest are payable annually and the source of the repayment comes from annual legislative assignments from the "Fondo de Mejoras Publicas". The maturity date of the line is June 30, 2018. As of June 30, 2012 this credit line amounted to \$1,127,183. On August 6, 2012 GDB and NPC amend the credit line terms and established the maturity date for June 30, 2040.
- In 2003 NPC entered into \$12 million line of credit agreement with GDB in order to finance the acquisition of a land lot named "Parque Capuchino". Borrowings under this line of credit bear interest at variable rates (7% as of June 30, 2012). The principal and interest are payable annually and the source of the repayment comes from annual legislative assignments from the "Fondo de Mejoras Publicas". The maturity date of the line was June 30, 2018. As of June 30, 2012 this credit line amounted to \$4,766,692. On August 6, 2012 GDB and NPC amend the credit line terms and established the maturity date for June 30, 2040.

As of June 30, 2012, credit lines are summarized as follows:

Description	Balance <u>June 30, 2011</u>	<u>Additions</u>	<u>Payments</u>	Balance <u>June 30, 2012</u>
Credit Line (\$12,000,000)	\$ 4,822,580	\$ -	\$ (55,888)	\$ 4,766,692
Credit Line (\$9,287,428)	1,140,399	-	(13,216)	1,127,183
Credit Line (\$10,000,000)	<u>7,087,146</u>	<u>-</u>	<u>(807,422)</u>	<u>6,279,724</u>
	13,050,125	\$ <u>-</u>	\$ <u>(876,526)</u>	12,173,599
Accrued Interests	<u>342,822</u>			<u>315,974</u>
	<u>\$ 13,392,947</u>			<u>\$ 12,489,573</u>

NOTE 6 - DUE TO OTHER GOVERNMENTAL ENTITIES

Amount due to the Sports and Recreational Department in the amount of \$10,734,156 represents unpaid advances used for salaries and fringe benefits up to June 30, 1990, which is offset with an account receivable, net of an allowance. The accounts receivable is related to utilities paid by NPC on behalf of the Sports and Recreational Department during the years from 1977 through 1998.

Total due from (due to), net, to the Sports and Recreational Department as of June 30, 2012 is as follows:

Due From the Department	\$ 10,037,493
Less: Allowance for Uncollectible Amount	<u>(1,232,982)</u>
	8,804,511
Due To the Department	<u>(10,734,156)</u>
Net Balance - Due to the Department	1,929,645
Employee Retirement System	7,915,732
Puerto Rico Electric Power Authority	3,991,304
Puerto Rico Aqueduct and Sewer Authority	<u>4,472,371</u>
Total Due to Governmental Entities	<u>\$ 18,309,052</u>

NOTE 7 - CHARGES FOR SERVICES FROM THE OPERATION OF RECREATIONAL FACILITIES

The following summarizes charges for services from the operation of recreational facilities and other revenues for the year ended June 30, 2012:

Cabins Rental	\$ 4,109,424
Parking	846,470
Sale of Tickets:	
Admission Fees	2,176,196
Lockers	1,589
Swimming Pool	31,436
Boat Ramp	26,320
Camping	245,917
Rent of Facilities	60,323
Restaurant Income	834,168
Trailers Income	497,510
Other Revenues	<u>299,765</u>
Total	<u>\$ 9,129,118</u>

NOTE 8 - PENSION PLAN

(A) Plan Description and Funding Policy

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of the Commonwealth of Puerto Rico. All regular employees of NPC under age 55 at the date of employment become members of the System as a condition to their employment.

The Retirement System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951 as amended, and became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and non occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Members who have attained an age of at least fifty-five (55) years and have completed at least twenty-five (25) years of creditable service or members who have attained age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service, are entitled to an annual benefit, payable monthly for life.

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

Participants who have completed at least thirty years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation or if they have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability requirement benefits are available to members for occupational and non-occupational disability. However, for non-occupational disability a member must have at least ten (10) years of service. No benefits are payable if participant receives a refund of his accumulated contributions.

Law No. 1 of February 16, 1990, made certain amendments applicable to new participants joining the System effective on April 1, 1990. Changes mainly consisted of an increase of the retirement age to 65 years, the elimination of the Merit Company and a reduction of the percentage for disability and death benefits.

Commonwealth legislation requires employees to contribute 5.775% for the first \$6,600 of their annual gross salary (\$550 monthly) and 8.275% for the annual salary in excess of \$6,600 for the employees hired on or before March 31, 1990. For employees hired on or after April 1, 1990 the required contribution is 8.275% of gross salary. NPC's contributions are 10.275% of gross salary, starting on July 1, 2011 from Law Number 116 (before Law 116, contribution was 9.275%).

Law No. 305, that was enacted on September 24, 1999, amended Law No. 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

NOTE 8 - PENSION PLAN (CONTINUED)**(A) Plan Description and Funding Policy (Continued)**

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. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (10.275% of the employees' salary) will be used to fund the current plan. Law Number 116 will require, from July 1, 2012 through June 30, 2016, annual increases in the employer contribution of 1%, and from July 1, 2016 through 2021, annual increases of 1.25%.

On August 12, 2000, the Legislature of Puerto Rico approved Law No. 174. The Act provides to certain employees of the Government of Puerto Rico the option for early retirement. To qualify, the employee should make an election between July 1, 2000 and September 30, 2000, and among other requirements, must have twenty five (25) years of creditable service.

(B) Annual Contributions

Total payroll covered for fiscal year 2012 was approximately \$15,569,660. Total approximate employee and employer contributions for the years ended June 30, 2012 are as follows:

<u>Description</u>	<u>Contribution</u>
Employer	\$ <u>1,217,933</u>
Employee	\$ <u>978,381</u>

NPC's actual contribution for the current and the previous two fiscal years, which is equal to the required contribution, follows:

<u>Fiscal year ended</u> <u>June 30</u>	<u>Amounted</u>
2012	\$ <u>1,217,933</u>
2011	\$ <u>859,417</u>
2010	\$ <u>1,177,018</u>

Additional information on the Retirement System is provided in its stand-alone financial statements for the year ended June 30, 2012, a copy of which can be obtained from the Employees Retirement System of the Commonwealth of Puerto Rico and its instrumentalities, PO Box 42004, San Juan, PR 00940-2004.

NOTE 9 - POSTEMPLOYMENT BENEFITS

In addition to the pension benefit described in Note 8, NPC is required to cover annually the 3% increase in the retirement plan of its retired employees, as required by Commonwealth's laws. Also, NPC is required to finance costs related to the applications of certain "Special laws" issued by the Government of Puerto Rico. Those Special Laws granted increases in pensions and other benefits to retired employees of NPC such as medicines, bonus and death benefits.

NOTE 10 - CONTINGENCIES**(A) LITIGATIONS**

NPC is a defendant or a co-defendant in various lawsuits and complaints. NPC's management, after consultation with legal counsel, has made a provision of \$2,620,837 for losses on these litigations. However, the ultimate amount payable in excess of the amount provided, if any, cannot be determined.

(B) COMPTROLLER'S OFFICE OF PUERTO RICO REPORTS

NPC is also audited by the Comptroller's Office of Puerto Rico (COPR), who has issued several reports on audits over operations of NPC. The oversight entities, such as the Puerto Rico Department of Justice, are evaluating actions to be taken against NPC and its employees. The financial impact if any of the possible actions to be taken by the oversight entities can not be presently determined.

(C) FEDERAL AWARDS

During the normal course of its operations, NPC receives grants funds from the Department of the Interior, land and water conservation fund. The grant programs are subject to audit by agents of the granting authorities, the purpose of which is to ensure compliance with conditions precedent to the granting of funds. Any liability for reimbursement which may arise as a result of the audits is not considered by management to have a significant effect in the accompanying basic financial statements.

NOTE 11 - COLLECTIVE BARGAINING AGREEMENT

The collective bargaining agreement of NPC covers 67.5% of total employees. The agreement entered into effect on September 1, 1997 until August 31, 2011. It was stipulated in the bargaining agreement a monthly salary increase of \$100 monthly per employee, effective September 1, 2008 and 2009, respectively. NPC guarantees \$300 for cost of Medical Plan.

The bargaining agreement also stipulates that if the Commonwealth of Puerto Rico authorizes a higher salary increase, NPC will pay any difference. A new agreement was signed on August 13, 2012 an entered into effect on July 1, 2012 until June 30, 2015.

NOTE 12 - TRANSFER OF CAPITAL ASSETS TO A MUNICIPALITY

On July 15, 2011 and August 16, 2012, NPC transferred to the Municipality of San Juan, for the nominal amount of \$1 dollar, the facilities of "Tercer Milenio Park" and "Laguna del Condado", respectively, including the operations, following the requirements of Joint Resolution No. 180 approved by the Puerto Rico Legislature on December 30, 2010. Both park and facilities, as of that date, had a book value of \$1,663,965 and \$8,332,763, respectively, which includes buildings and improvements made. As part of the transfer, the Municipality agreed to comply with certain restrictions related to the use of the transferred capital assets imposed by the Code of Federal Regulations and the Land and Water Conservation Fund Act.

During fiscal year 2012-2013 NPC will be in the process of transferring other capital assets to the Municipality of Arroyo, also for a nominal value, including the facilities and operations of "Balneario y Centro Vacacional de Arroyo".

NOTE 13 - POST-EMPLOYMENT BENEFITS AND TERMINATION BENEFITS

On July 2, 2010, the Commonwealth of Puerto Rico 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 NPC. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of creditable services and will consist of biweekly benefits ranging from 37.5% to 50 % of each employee' salary, as defined. In this early retirement benefits, the NPC 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 creditable services applicable to the Retirement System. Economic incentives are available to eligible employees that have less than 15 years of creditable services or that qualify for retirement benefits. Economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary. Additionally, eligible employees that choose to participate in this program, other than those who qualify for retirement benefits, are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Commonwealth.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the NPC's financial statements of a liability of \$12,069,871 in the statement of net assets as of June 30, 2012 and a charge of \$1,139,483 as Employee Future Benefits in the statement of activities for the year ended June 30, 2012.

NOTE 14 - RESTATEMENT OF NET ASSETS

During the year ended June 30, 2012, NPC identified and corrected certain accounting transactions belonging to prior years. The effect of these prior period adjustments on the net assets of NPC as of July 1, 2010 is as follows:

Net Assets - Beginning of Year, as Previously Reported	\$ 155,659,326
Restatement Adjustment, Net:	
Accounts Payable Aging	<u>211,340</u>
Net Assets - Beginning of Year, as Restated	<u>\$ 155,870,666</u>