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Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund

(An Enterprise Fund of the
Commonwealth of Puerto Rico)

Basic Financial Statements and Required
Supplementary Information as of and
for the Year Ended June 30, 2009, and
Independent Auditors' Report

PO_8650

**PUERTO RICO SAFE DRINKING WATER TREATMENT
REVOLVING LOAN FUND**
(An Enterprise Fund of the Commonwealth of Puerto Rico)

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Puerto Rico Safe Drinking Water Treatment
Revolving Loan Fund
San Juan, Puerto Rico

We have audited the accompanying statement of net assets of Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the "Revolving Fund"), an enterprise fund of the Commonwealth of Puerto Rico (the "Commonwealth"), as of June 30, 2009, and the related statements of revenues, expenses, and change in net assets and of cash flows for the year the ended. These financial statements are the responsibility of the Revolving Fund'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. 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 Revolving Fund'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 statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund as of June 30, 2009, and the change in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 2 through 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Revolving Fund's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Deloitte & Touche LLP

February 23, 2010

Stamp No. 2373574
Affixed to original.

PUERTO RICO SAFE DRINKING WATER TREATMENT REVOLVING LOAN FUND

(An Enterprise Fund of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS AS OF AND FOR THE YEAR ENDED JUNE 30, 2009

As financial management of the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the "Revolving Fund"), we offer readers of the Revolving Fund's financial statements this narrative overview and analysis of the Revolving Fund's financial performance during the fiscal year ended June 30, 2009. This discussion and analysis is designed to assist the reader in focusing on the significant financial issues and activities and to identify any significant changes in the financial position of the Revolving Fund. We encourage readers to consider the information presented here in conjunction with the basic financial statements as a whole, which follow this section.

1. FINANCIAL HIGHLIGHTS

- The Revolving Fund's net assets increased \$21.6 million or 21% over the course of the year's operations. Grants and contributions decreased by \$3.0 million or 13% when compared to grants and transfers received in the prior year.
- Operating income before grants and contributions was \$1.5 million for fiscal year 2009, an increase of approximately \$400 thousand when compared to the operating income of \$1.1 million in fiscal year 2008.
- Grants received from the federal government were \$16.7 million while transfers from the Commonwealth of Puerto Rico (the "Commonwealth") amounted to \$3.3 million, during the year ended June 30, 2009.
- Loan disbursements made by the Revolving Fund to the Puerto Rico Aqueduct and Sewer Authority ("PRASA") to finance its capital improvement program amounted to approximately \$21.5 million, a decrease of \$1.8 million, or 8% from the amount disbursed during the previous year.

2. OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Revolving Fund's basic financial statements, which are comprised of the financial statements and the notes to the financial statements. Since the Revolving Fund is comprised of a single enterprise fund, no fund level financial statements are shown.

Basic Financial Statements — The basic financial statements are designed to provide readers with a broad overview of the Revolving Fund's finances, in a manner similar to a private-sector business.

The statement of net assets presents information on all of the Revolving Fund's assets and liabilities, with the difference between the two reported as net assets. Net assets increase when revenues exceed expenses. Increases to assets without a corresponding increase to liabilities result in increased net assets, which indicate an improved financial position.

The statement of revenues, expenses, and change in net assets presents information showing how an entity's net assets changed during the fiscal year. All changes in net assets are reported as soon as the underlying event occurs, regardless of timing of related cash flows.

The last of the required financial statement is the statement of cash flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and capital and non capital financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Notes to the Basic Financial Statements — The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements.

3. FINANCIAL ANALYSIS

Net assets may serve, over time, as a useful indicator of whether a governmental entity's financial position is improving or deteriorating. In the case of the Revolving Fund, assets exceeded liabilities by approximately \$126.3 million at June 30, 2009. This represents an increase of \$21.6 million or 21% over net assets at June 30, 2008. The total amount of net assets is restricted as it only serves the purpose provided by the enabling legislation of providing loans and financing for drinking water infrastructure facilities. As of June 30, 2009, all loans have been granted to PRASA.

Under Act No. 386 of September 21, 2004, the Commonwealth guarantees the payment of principal and interest on most of the outstanding Revolving Fund loans issued to PRASA on or before June 30, 2010. As of June 30, 2009, principal in the amount of \$102 million, plus any interest accrued on it, out of the \$114.2 million in outstanding loans to PRASA are guaranteed by the Commonwealth. The Revolving Fund's management believes that the loans are fully collectible, and has not established an allowance for loan losses.

The operation of the Revolving Fund is subject to the capital financing requirements of PRASA and/or any other qualifying entity, and therefore, loan origination activity will be determined on an annual basis, depending upon PRASA's and/or any other applying entity's needs.

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

	June 30,		Change	
	2009	2008	Amount	Percent
Cash	\$ 11,193	\$ 8,970	\$ 2,223	25 %
Loans	114,200	95,049	19,151	20
Interest receivable	<u>1,017</u>	<u>875</u>	<u>142</u>	16
Total assets	126,410	104,894	21,516	21
Liabilities	<u>63</u>	<u>175</u>	<u>(112)</u>	(64)
Restricted net assets	<u>\$ 126,347</u>	<u>\$ 104,719</u>	<u>\$ 21,628</u>	21

The comparative data shows an increase in loans of \$19.2 million from 2008. Said increase was funded with grants and transfers from the U.S. Federal Government and the Commonwealth amounting to \$20 million, which in turn resulted in the increase in net assets.

Condensed financial information on revenues, expenses, and change in net assets is presented below (in thousands):

	June 30,		Change	
	2009	2008	Amount	Percent
Operating revenues — interest	\$ 2,104	\$ 1,927	\$ 177	9 %
Operating expenses — general and administrative	<u>571</u>	<u>809</u>	<u>(238)</u>	(29)
Operating income before grants and contributions	1,533	1,118	415	37
Grants and contributions	<u>20,095</u>	<u>23,133</u>	<u>(3,038)</u>	(13)
Change in restricted net assets	21,628	24,251	(2,623)	(11)
Restricted net assets — beginning of year	<u>104,719</u>	<u>80,468</u>	<u>24,251</u>	30
Restricted net assets — end of year	<u>\$ 126,347</u>	<u>\$ 104,719</u>	<u>\$ 21,628</u>	21

During 2009, the Revolving Fund invested its operating cash in interest earning cash accounts to maximize its return thus increasing revenues from interest. Grants decreased parallel to the reduction in loan disbursements. Note that grants are received to the extent disbursements are required under outstanding loan commitments.

4. REQUESTS FOR INFORMATION

This financial report is designed to provide those interested with a general overview of the Revolving Fund's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, at Government Development Bank for Puerto Rico, P.O. Box 42001, San Juan, Puerto Rico, 00940-2001.

**PUERTO RICO SAFE DRINKING WATER TREATMENT
REVOLVING LOAN FUND
(An Enterprise Fund of the Commonwealth of Puerto Rico)**

**STATEMENT OF NET ASSETS
AS OF JUNE 30, 2009**

ASSETS:

Current assets:

Cash	\$ 11,193,416
Accrued interest receivable	1,017,218
Loans receivable from PRASA	<u>4,102,793</u>

Total current assets 16,313,427

Noncurrent assets — loans receivable from PRASA 110,096,648

Total assets 126,410,075

LIABILITIES — Current liabilities — accounts payable 62,869

RESTRICTED NET ASSETS \$126,347,206

See notes to basic financial statements.

**PUERTO RICO SAFE DRINKING WATER TREATMENT
REVOLVING LOAN FUND**
(An Enterprise Fund of the Commonwealth of Puerto Rico)

**STATEMENT OF REVENUES, EXPENSES, AND CHANGE IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2009**

OPERATING REVENUES — Interest earned on:	
Loans	\$ 1,991,097
Deposits	<u>113,217</u>
Total interest earned	2,104,314
OPERATING EXPENSES — General and administrative	<u>570,520</u>
OPERATING INCOME	<u>1,533,794</u>
NONOPERATING REVENUES:	
Environmental Protection Agency capitalization grant	16,767,837
Contributions from Commonwealth of Puerto Rico	<u>3,326,896</u>
Total nonoperating revenues	<u>20,094,733</u>
CHANGE IN RESTRICTED NET ASSETS	21,628,527
RESTRICTED NET ASSETS — Beginning of year	<u>104,718,679</u>
RESTRICTED NET ASSETS — End of year	<u>\$ 126,347,206</u>

See notes to basic financial statements.

**PUERTO RICO SAFE DRINKING WATER TREATMENT
REVOLVING LOAN FUND**
(An Enterprise Fund of the Commonwealth of Puerto Rico)

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2009**

CASH FLOWS FROM OPERATING ACTIVITIES — Administrative expenses paid	\$ (682,972)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Loans originated	(21,474,024)
Principal collected on loans	2,323,175
Interest received on deposits	125,800
Interest received on loans	<u>1,836,359</u>
Net cash used in investing activities	<u>(17,188,690)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Funds received from Environmental Protection Agency	16,767,837
Funds received from Commonwealth of Puerto Rico	<u>3,326,896</u>
Net cash provided by noncapital financing activities	<u>20,094,733</u>
NET INCREASE IN CASH	2,223,071
CASH — Beginning of year	<u>8,970,345</u>
CASH — End of year	<u>\$ 11,193,416</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:	
Operating income	\$ 1,533,794
Adjustments to reconcile operating income to net cash used in operating activities:	
Interest income on deposits	(113,217)
Interest income on loans	(1,991,097)
Decrease in accounts payable	<u>(112,452)</u>
NET CASH USED IN OPERATING ACTIVITIES	<u>\$ (682,972)</u>

See notes to basic financial statements.

**PUERTO RICO SAFE DRINKING WATER TREATMENT
REVOLVING LOAN FUND
(An Enterprise Fund of the Commonwealth of Puerto Rico)**

**NOTES TO BASIC FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2009**

1. REPORTING ENTITY

Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund (the “Revolving Fund”) was created by Act No. 32 of the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) on July 7, 1997. The Revolving Fund was constituted separately and independently from any other funds or resources of the Commonwealth. It is presented as an enterprise fund of the Commonwealth.

The Revolving Fund is administered, pursuant to Act No. 5 of July 21, 1977, as amended, by the Puerto Rico Department of Health (“DOH”). Pursuant to such act, DOH, on behalf of the Commonwealth, is authorized to enter into operating agreements and capitalization grant agreements with the U.S. Environmental Protection Agency (“EPA”). DOH, Puerto Rico Infrastructure Financing Authority (“PRIFA”), Puerto Rico Aqueduct and Sewer Authority (“PRASA”), and Government Development Bank for Puerto Rico (the “Bank”) entered into a memorandum of understanding under which each party has agreed to assume specific responsibilities in connection with the operations of the Revolving Fund. Under the memorandum of understanding, the Bank provides assistance in maintaining the accounting records of the Revolving Fund.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Following is a description of the Revolving Fund’s most significant accounting policies:

Measurement Focus and Basis of Accounting — Proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows.

Operating Revenues and Expenses — Proprietary funds distinguish operating revenues and expenses from nonoperating items. The principal operating revenues of the Revolving Fund are interest earned on loans granted under its loan program and interest earned on deposits. Operating expenses are those related to the administration of the entity. All revenues and expenses not meeting these criteria are reported as nonoperating revenues and expenses.

Loans — The Revolving Fund is operated as a direct loan program, whereby loans made to PRASA are, approximately, 80% funded by EPA and 20% by the Commonwealth matching amount. Loans are disbursed to PRASA as they expend funds for the purposes of the loan, and request reimbursement from the Revolving Fund. Loans are presented at the outstanding unpaid principal balance. Under Act No. 386 of September 21, 2004, the Commonwealth guarantees the payment of principal and interest on most of the outstanding Revolving Fund loans issued to PRASA on or before June 30, 2010.

Management believes that no losses will be incurred by the Revolving Fund with respect to principal and interest on loans to PRASA, and, as a result, such loans are not classified as impaired and no allowance for loan losses is generally established for them. As of June 30, 2009, the Revolving Fund has approximately \$28.2 million in commitments to extend additional credit to PRASA.

The accounting and reporting policies of the Revolving Fund conform to accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Revolving Fund follows Governmental Accounting Standards Board ("GASB") under the hierarchy established by Statement No. 55, *The Hierarchy of Generally Accepted Principles for State and Local Governments*, in the preparation of its financial statements. In the past, the Revolving Fund followed Financial Accounting Standards Board pronouncements to the extent they did not conflict with GASB pronouncements.

In March 2009, the GASB issued the statement No. 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. This Statement incorporates accounting and financial reporting guidance previously contained in the American Institute of Certified Public Accountants ("AICPA") auditing literature into the GASB's accounting and financial reporting literature for state and local governments. Statement No. 56 addresses three issues from the AICPA's literature — related party transactions, going concern considerations, and subsequent events. The Statement brings existing guidance without substantive changes into the GASB's body of standards, as appropriate for governmental entities. Statement No. 56 was effective immediately upon issuance. The adoption of GASB No. 56 did not have a material impact on the Revolving Fund's financial position or results of operations.

The GASB has issued the following accounting pronouncements that have effective date after June 30, 2009:

- a. GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which is effective for financial statements for periods beginning after June 15, 2009.
- b. GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, which is effective for financial statements for periods beginning after June 15, 2009.
- c. GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, which is effective for periods beginning after June 15, 2010.

The impact of these pronouncements in the Revolving Fund's financial statements has not yet been determined.

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the Revolving Fund's deposit may not be returned to it. The Revolving Fund does not have a deposit policy for custodial credit risk. As of June 30, 2009, all of the Revolving Fund's bank balance, aggregating approximately \$11,193,000, was exposed to custodial credit risk since such deposits, all of which are maintained at the Bank, are uninsured and uncollateralized.

4. **TRANSACTIONS WITH GOVERNMENT DEVELOPMENT BANK FOR PUERTO RICO**

As of June 30, 2009, the depository bank balance represents interest-bearing demand deposits with the Bank. The Bank is another component unit of the Commonwealth. Since the Revolving Fund has no employees, the Bank provided certain management services to the Revolving Fund at no cost.

5. **LOANS RECEIVABLE**

Loans receivable at June 30, 2009, consist of:

Description	Amount
Permanent loans	\$ 91,565,198
Construction loans	<u>22,634,243</u>
	<u>\$114,199,441</u>

Permanent loans are due in semiannual installments bearing interest at 2% per annum, maturing on various dates through January 1, 2029. Permanent loans receivable at June 30, 2009, mature as follows:

Years Ending June 30,	Amount
2010	\$ 4,102,793
2011	4,185,259
2012	4,269,383
2013	4,355,197
2014	4,442,737
Thereafter	<u>70,209,829</u>
	<u>\$91,565,198</u>

Construction loans bear interest at 2% per annum and will be payable semiannually commencing no later than one year after construction completion date and must be paid in full in a period not to exceed 20 years after the first payment.

6. **CAPITALIZATION GRANTS**

The Revolving Fund is capitalized by grants from EPA authorized by Title VI of the Act and matching funds from the Commonwealth. These grants are routinely subject to financial and compliance audits in accordance with the provisions of the U.S. Office of Management and Budget Circular A-133 and compliance audits by EPA. The latter has the authority to determine liabilities as well as to limit, suspend, or terminate the federal assistance. All funds drawn from EPA and the matching funds from the Commonwealth are recorded as non-operating revenues. As of June 30, 2009, EPA has awarded capitalization grants of \$113,231,338 to the Commonwealth of which \$94,121,653 has been drawn for loans and administrative expenses. The Commonwealth has provided matching funds of approximately 20%.

The following summarizes the capitalization grants awarded, amounts drawn on each grant as of the statement of net assets date, and balances available for future loans:

June 30,	Grant Amount	Total Draws at June 30, 2008	Draws During 2009	Total Draws at June 30, 2009	Available at June 30, 2009
1998	\$ 23,011,638	\$22,783,801	\$ -	\$22,783,801	\$ 227,837
1999	10,716,700	10,716,700		10,716,700	-
2000	11,137,800	11,137,652		11,137,652	148
2001	11,183,800	11,175,427		11,175,427	8,373
2002	10,741,300	10,655,768	85,532	10,741,300	-
2003	10,676,700	293,910	329,226	623,136	10,053,564
2004	11,075,500	6,236,888	4,037,980	10,274,868	800,632
2005	8,229,300		2,556,066	2,556,066	5,673,234
2006	8,229,300	4,353,671	1,839,025	6,192,696	2,036,604
2007	8,229,300		7,920,007	7,920,007	309,293
	<u>\$113,231,338</u>	<u>\$77,353,817</u>	<u>\$16,767,836</u>	<u>\$94,121,653</u>	<u>\$19,109,685</u>

7. ADMINISTRATIVE EXPENSES

As provided by federal laws and regulations, reasonable costs of administering the Revolving Fund are reimbursable under federal programs up to a maximum of 4% of the capitalization grant awarded. The federal government also reimburses expenses incurred in training and certifying personnel as well as technical matters. Grants from the federal government during 2009 include approximately \$554,000 that represents reimbursement of administrative expenses.

* * * * *