OFICINA DEL PRESIDENTE DEL SENADO
HON. THOMAS RIVERA SCHATZ

HOJA DE TRÁMITE

Fecha referido: 3 DE MAYO DE 2012

Referido a: SRA. MADELINE RIVERA, SUBSECRETARIA DEL SENADO DE PUERTO RICO

Copia Com. Trabajo

De: GINA HERNÁNDEZ GONZÁLEZ, SECRETARIA EJECUTIVA OFICINA DEL PRESIDENTE DEL SENADO

Asunto:
1. ADJUNTO INFORME ANUAL 2010-2011 QUE ENVIARA EL SR. ÁNGEL L. FEBUS MARRERO, DIRECTOR EJECUTIVO DE LA COMISIÓN ESPECIAL PERMANENTE SOBRE LOS SISTEMAS DE RETIRO. ✓
2. ADJUNTO ESTADO FINANCIERO QUE ENVIARAN DEL BANCO GUBERNAMENTAL DE FOMENTO. ✓
3. ADJUNTO ESTADO FINANCIERO ENVIADO POR LA CORPORACIÓN PARA EL FINANCIAMIENTO DE PR. ✓

Dar curso

______ Para su conocimiento

__✓__ Para acción correspondiente

______ Para trabajar y contestar directamente

______ Autorizado

OBSERVACIONES

____

Recibido por________________ Fecha______________ Hora ______________

SENADO
GOBIERNO DE PUERTO RICO

Iniciales

Oficina del President

Katherine Erazo
CHIEF OF STAFF

Fecha 2 de mayo de 2012

Referido a [illegible]

- Para su información
- Evaluar y recomendar
- ✓ Para trabajar y contestar directamente
- Dar cuenta al cuerpo
- Para otorgar contrato
- Para nombramiento
- Autorizado

Madeliè

Secretaría

- [ ] Ver al dorso
- [ ] Para su información
- [ ] Notas
- [ ] Para mantenerle al día
- [ ] Expediente
- [x] Dar Cuenta
- [ ] Registrar y Procesar

Senado
DE PUERTO RICO

EL CAPITOLIO
PO Box 9023431
San Juan, Puerto Rico
00902-3431

T: 787.722.3460
787.722.4012
F: 787.723.5413
W: www.senadopr.us

REFERIDO A:

COMISIONES PERMANENTES

- ☐ Hacienda
- ☐ Gobierno
- ☐ Seguridad Pública y Judicatura
- ☐ Salud
- ☐ Educación y Asuntos de la Familia
- ☐ Desarrollo Eonómico y Planificación
- ☐ Urbanismo e Infraestructura
- ☐ Jurídico Penal
- ☐ Jurídico Civil
- ☐ Agricultura
- ☐ Recursos Naturales y Ambientales
- ☐ Comercio y Cooperativismo
- ☐ Turismo y Cultura
- ☐ Trabajo, Asuntos del Veterano y Recursos Humanos
- ☐ Bienestar Social
- ☐ Asuntos Municipales
- ☐ Recreación y Deportes
- ☐ Banca, Asuntos del Consumidor y Corporaciones Públicas
- ☐ Desarrollo de la Región del Oeste
- ☐ Asuntos de la Mujer
- ☐ Asuntos Internos
- ☐ Reglas y Calendario
- ☐ Asuntos Federales
- ☐ De la Montaña
- ☐ Ética

COMISIONES ESPECIALES

- ☐ Puerto de las Américas
- ☐ Derecho de Autodeterminación del Pueblo de Puerto Rico
- ☐ Sobre Reforma Gubernamental

COMISIONES CONJUNTAS

- ☐ Informes Especiales del Contralor
- ☐ Donativos Legislativos de Puerto Rico
- ☐ Internado Córdova-Fernós
- ☐ Internado Pilar Barbosa
- ☐ Internado Ramos Comas
- ☐ Código Penal
- ☐ Revisión y Reforma del Código Civil
- ☐ Alianzas Público Privadas
- ☐ Auditoría Fiscal y Manejo Fondos Públicos
- ☐ Revisión Continua Código Penal y Reforma de las Leyes

15784

Puerto Rico Sales Tax Financing Corporation

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information as of and for the Year Ended June 30, 2011, and Independent Auditors' Report

5/1/2012
3:22

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

TABLE OF CONTENTS

Deloitte & Touche LLP
Torre Chardon
350 Chardon Avenue, Ste. 700
San Juan, PR 00918
USA

Tel: +1 787 759 7171
www.deloitte.com

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Puerto Rico Sales Tax Financing Corporation
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities and each major fund of Puerto Rico Sales Tax Financing Corporation (the "Corporation"), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2011, which collectively comprise the Corporation's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Corporation'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 respective 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 Corporation'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 respective 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, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of Puerto Rico Sales Tax Financing Corporation, as of June 30, 2011, and the respective changes in financial position 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 5 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 Corporation's management. 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 such information and we do not express an opinion on it.

Deloitte & Touche LLP

April 27, 2012

Stamp No. E26145
affixed to original.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2011

As management of the Puerto Rico Sales Tax Financing Corporation (the "Corporation"), we offer readers of the Corporation's financial statements this narrative overview and analysis of the financial performance during the fiscal year ended June 30, 2011. Please read it in conjunction with the Corporation's basic financial statements including the notes thereto, which follow this section.

1. **Financial highlights:**

- The Corporation issued approximately $327.5 million of Sales Tax Revenue Bonds, Junior Subordinate Series 2011A. The proceeds from the bond issuance were deposited in an interest bearing account and will mainly be used to fund the Puerto Rico Stabilization Fund.

- Net deficit government wide grew to $13,547 million at June 30, 2011 from $11,785 million at June 30, 2010. The increase in net deficit is mainly due to the payment of obligations of the Commonwealth of Puerto Rico of approximately $1,553 million and interest expense on Sales Tax Revenue Bonds of approximately $801.3 million offset by Pledge Sales Tax received from the Commonwealth of Puerto Rico of approximately $572.3 million. Net deficit was also impacted by the change in fair value of investment derivative instruments. At June 30, 2011, the fair value of investment derivative instruments was a liability of approximately $173.5 million, while at June 30, 2010 the fair value was a liability of $195.9 million; a positive change of $22.4 million (see Notes 2 and 7 for further details related to derivative instruments).

- Revenues from pledged sales taxes increased to $572.3 million in fiscal year 2011 from $550.8 million in fiscal year 2010, an increase of $21.5 million. This increase was due to a statutory rate increase of 4% provided by Act No. 91, as amended. See Note 1.

2. **Overview of the financial statements:**

These financial statements include the management's discussion and analysis section, the independent auditors' report, and the basic financial statements of the Corporation. The basic financial statements also include notes that explain in more detail some of the information in the basic financial statements.

3. **Required financial statements:**

- The statement of net deficit provides information about the nature and amounts of resources (assets) and the Corporation's obligations (liabilities).

- Current year revenues and expenses are accounted for in the statement of activities. This statement measures the results of the Corporation's operations over the past year.

- Governmental funds' financial statements present the financial position and results of operations of the Corporation's two governmental fund types using a current financial resources measurement focus. The statement of revenues, expenditures, and changes in fund balance can be used to determine, for example, whether and how the Corporation met its debt service requirements for the year.

4. Financial analysis:

In evaluating the Corporation's finances, in addition to the Corporation's assets and liabilities, one needs to consider various non-financial factors, such as changes in economic conditions, and new or changed government legislation. Due to the nature of the Corporation's activities, the Corporation's financial strength and ability to repay its obligations is solely dependent on the sales tax transferred to the Corporation by law and used to fund the debt service fund. Since its inception, the sales tax has proven to be resilient and is the Commonwealth's strongest tax pledge.

For additional information about the sales tax transferred to the Corporation, refer to Note 1 to these financial statements.

5. Government wide financial analysis:

The government wide financial statements were designed so that the user could evaluate the Corporation's financial condition at the end of the year. The following is a condensed summary of net deficit for the Corporation at June 30, 2011 and 2010 (amounts in thousands):

	June 30,		Change	
	2011	2010	Amount	Percent
ASSETS:				
Unrestricted assets	$ 20,190	$ 18,113	$ 2,077	11.47 %
Restricted assets	1,320,584	2,536,613	(1,216,029)	(47.94)%
Total assets	1,340,774	2,554,726	(1,213,952)	(47.52)%
LIABILITIES:				
Accounts payable and other	3,424	20	3,404	17020.00 %
Liabilities payable from restricted assets	14,884,464	14,339,642	544,822	3.80 %
Total liabilities	14,887,888	14,339,662	548,226	3.82 %
NET DEFICIT– Unrestricted	$ (13,547,114)	$ (11,784,936)	$(1,762,178)	14.95 %

As noted above, the Corporation's deficit at June 30, 2011, amounted to $13,547 million, an increase of $1,762 million or 14.95% from $11,785 million at June 30, 2010. At June 30, 2011, the Corporation had $14,399 million of bonds payable outstanding an increase of $544 million or 3.9% from $13,855 million at June 30, 2010. In addition, as of June 30, 2011, the Corporation has accrued $3.4 million to cover for any unfavorable outcome related to a claim in connection with the termination of an interest rate exchange agreement in 2008, refer to Note 8. Restricted assets mainly consist of investments held by the trustee for the Corporation's debt service, which are funded mostly from the collection of the Dedicated Sales Tax Fund, and investments restricted by law to be used in certain authorized purposes of the Corporation. (Refer to Note 1.)

Condensed revenues, expenses, and change in net deficit for the year ended June 30, 2011 and 2010, are presented below (amounts in thousands):

	June 30,		Change	
	2011	2010	Amount	Percent
GOVERNMENTAL ACTIVITIES:				
Payment of obligation of the Commonwealth of Puerto Rico, net	$ (1,553,353)	$ (2,899,116)	$ 1,345,763	(46.42)%
Interest on long-term debt, net	(777,597)	(753,086)	(24,511)	3.25 %
Pledged sales tax from the Commonwealth	572,274	550,846	21,428	3.89 %
Total governmental activities	(1,758,676)	(3,101,356)	1,342,680	(43.29)%
GENERAL EXPENSES — Professional fees and other	(3,502)	(999)	(2,503)	250.55 %
Change in net deficit	$ (1,762,178)	$ (3,102,355)	$ 1,340,177	(43.20)%

For the year ended June 30, 2011, revenues to fund the debt service totaled $573.6 million; $572.3 million from the collection of sales taxes of the Dedicated Sales Tax Fund and $1.3 million from investments. Revenues also include in 2011 the positive change in fair value of investment derivative instruments amounting to $22.4 million. For the year ended June 30, 2010, revenues to fund the debt service totaled $552.8 million; $550.8 million from the collection of sales taxes of the Dedicated Sales Tax Fund and $2.0 million from investments.

6. Governmental fund financial analysis:

The Corporation's governmental funds reported a total fund balance as of June 30, 2011 and 2010, of $1,024 million and $2,210 million, respectively. The debt service fund is funded with the Pledged Sales Tax revenues and interest thereon. For the years ended June 30, 2011 and 2010, the Pledged Sales Tax revenues amounted to $580.0 million and $550.3 million, respectively. During fiscal year 2011, total revenues received exceeded the Pledged Sales Tax Base Amount by approximately $7.7 million, while in fiscal year 2010 revenues received equaled the base amount for the year.

7. Debt administration:

During the year ended June 30, 2011, the Corporation issued $327.5 million on Sales Tax Revenue Bonds. As of June 30, 2011, the Corporation's outstanding bonds balance was $14,399 million, after taking into account unamortized bond premium of $61.7 million, deferred refunding gain of $109.8 million, deferred refunding loss of $38.5 million, and unaccreted discount of $115.9 million. As of June 30, 2010, the Corporation's outstanding bonds balance was $13,855 million, after taking into account unamortized bond premium of $63.2 million, deferred refunding gain of $112.1 million, deferred refunding loss of $39.9 million, and unaccreted discount of $117.8 million. The bonds are payable in various dates through fiscal year 2058.

8. Request for information:

This financial report is designed to provide those interested with a general overview of the Corporation's finances and to enhance the Corporation's accountability for the funds it receives. Questions about this report or requests for additional information should be addressed to Puerto Rico Sales Tax Financing Corporation, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET DEFICIT
AS OF JUNE 30, 2011

ASSETS:		
Interest-bearing deposits with Government Development Bank for Puerto Rico	$	20,189,194
Accrued interest receivable		607
Restricted assets:		
Interest-bearing deposits with Government Development Bank for Puerto Rico		352,954,245
Cash held by trustee		4,973,420
Accrued interest receivable		97
Pledged sales tax receivable		96,651,831
Investments		645,582,083
Other receivables		740,274
Deferred outflow of resources		37,222,368
Deferred bond issue costs		182,459,767
Total assets		1,340,773,886
LIABILITIES:		
Accounts payable and other		3,423,678
Liabilities payable from restricted assets:		
Accrued interest payable		177,877,642
Deferred revenue		96,651,831
Interest rate swap liablity		210,724,675
Bonds payable due in more than one year — net		14,399,209,817
Total liabilities		14,887,887,643
NET DEFICIT — Unrestricted	$	(13,547,113,757)

See notes to basic financial statements.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

Functions/Programs	Expenses	Program Revenues: Investment Earnings	Program Revenues: Pledged Sales Tax from the Commonwealth	Net Expenses and Changes in Net Deficit
GOVERNMENTAL ACTIVITIES:				
Payment of obligations of the Commonwealth of Puerto Rico	$ 1,553,362,174	$ 9,597	$ -	$ (1,553,352,577)
Interest on long-term debt	801,347,739	23,750,354	572,274,560	(205,322,825)
Total governmental activities	$ 2,354,709,913	$ 23,759,951	$ 572,274,560	(1,758,675,402)
GENERAL EXPENSES — Professional fees and other				(3,501,925)
CHANGE IN DEFICIT				(1,762,177,327)
DEFICIT — Beginning of year				(11,784,936,430)
DEFICIT — End of year				$(13,547,113,757)

See notes to basic financial statements.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

BALANCE SHEET — GOVERNMENTAL FUNDS
AS OF JUNE 30, 2011

	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS			
Interest-bearing deposits with Government Development Bank of Puerto Rico	$ 358,355,170	$ 14,788,269	$ 373,143,439
Cash held by trustee		4,973,420	4,973,420
Pledged sales tax receivable		96,651,831	96,651,831
Accrued interest receivable	607	97	704
Other receivables		740,274	740,274
Investments	156,893,518	488,688,565	645,582,083
TOTAL ASSETS	$ 515,249,295	$ 605,842,456	$ 1,121,091,751
LIABILITIES AND FUND BALANCES			
Accounts payable	$ 23,678	$ -	$ 23,678
Deferred revenue		96,651,831	96,651,831
Total liabilities	23,678	96,651,831	96,675,509
FUND BALANCES:			
Restricted	515,248,688	509,190,625	1,024,439,313
Unassigned	(23,071)		(23,071)
Total fund balances	515,225,617	509,190,625	1,024,416,242
TOTAL LIABILITIES AND FUND BALANCES	$ 515,249,295	$ 605,842,456	$ 1,121,091,751

See notes to basic financial statements.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF BALANCE SHEET OF GOVERNMENTAL FUNDS TO THE STATEMENT OF NET DEFICIT
AS OF JUNE 30, 2011

FUND BALANCES OF GOVERNMENTAL FUNDS	$ 1,024,416,242
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF NET DEFICIT ARE DIFFERENT BECAUSE:	
Bond issue costs are paid from current available resources in the governmental funds financial statements; however, these costs are capitalized and amortized over the life of the bonds and are included in the statement of net deficit	182,459,767
Deferred outflow of resources are not available to pay for current period expenditures and, therefore, are not reported in the funds	37,222,368
Accrued interest payable and contingent liabilities are not due and payable in the current period, and therefore, are not reported in the fund financial statements	(181,277,642)
Bonds payable and interest rate swap liability are not due and payable in the current period, and therefore, are not reported in the funds	(14,609,934,492)
DEFICIT OF GOVERNMENTAL ACTIVITIES	$ (13,547,113,757)

See notes to basic financial statements.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES — GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Pledged sales taxes from the Commonwealth of Puerto Rico	$ -	$ 580,011,896	$ 580,011,896
Investment earnings	553,882	795,603	1,349,485
Total revenues	553,882	580,807,499	581,361,381
EXPENDITURES:			
General government	62,714	39,211	101,925
Payment of obligations of the Commonwealth of Puerto Rico	1,553,362,174		1,553,362,174
Debt service — Interest		540,571,562	540,571,562
Total expenditures	1,553,424,888	540,610,773	2,094,035,661
EXCESS (SHORTAGE) OF REVENUES OVER EXPENDITURES	(1,552,871,006)	40,196,726	(1,512,674,280)
OTHER FINANCING SOURCES AND (USES) OF FUNDS:			
Proceeds from bonds issued		327,511,654	327,511,654
Transfer in (out)	1,167,924,313	(1,167,924,313)	
Total other financing sources (uses)	1,167,924,313	(840,412,659)	327,511,654
NET CHANGE IN FUND BALANCES	(384,946,693)	(800,215,933)	(1,185,162,626)
FUND BALANCES — Beginning of year	900,172,310	1,309,406,558	2,209,578,868
FUND BALANCES — End of year	$ 515,225,617	$ 509,190,625	$ 1,024,416,242

See notes to basic financial statements.

PUERTO RICO SALES TAX FINANCING CORPORATION
(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011

NET CHANGE IN FUND BALANCES OF GOVERNMENTAL FUNDS	$ (1,185,162,626)
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF ACTIVITIES ARE DIFFERENT BECAUSE:	
Interest on bonds payable not yet due reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as expenditure in the governmental funds	(37,661,828)
Net change in fair value of investment derivative instruments does not require the use of current financial resources and, therefore, are not reported as investment revenue in the funds	22,410,466
Revenues related to prior periods that become available during the current period are reported in government funds but are eliminated in the statement activities	(7,737,336)
Some expenses in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds	(3,400,000)
The issuance of long-term debt (e.g., bonds, notes) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on the net deficit. Also, governmental funds report the effect of issuance costs, premiums, discounts, and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items	(550,626,003)
CHANGE IN NET DEFICIT OF GOVERNMENTAL ACTIVITIES	$ (1,762,177,327)

See notes to basic financial statements.

1. REPORTING ENTITY

Puerto Rico Sales Tax Financing Corporation (the "Corporation") is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth") and an affiliate of Government Development Bank for Puerto Rico (the "Bank"), another component unit of the Commonwealth. The Corporation was created under Act No. 91 of the Legislative Assembly of the Commonwealth (the "Legislative Assembly"), approved on May 13, 2006, as amended by Act No. 291, approved on December 26, 2006, Act No. 56, approved on July 6, 2007, Act No. 1, approved on January 14, 2009, Act No. 7, approved on March 9, 2009 ("Act 7"), and Act No. 18, approved on May 22, 2009 (collectively, "Act 91"). The Corporation was originally created for the purpose of financing the payment, retirement or defeasance of certain debt obligations of the Commonwealth outstanding as of June 30, 2006 (the "2006 Appropriation Debt").

The Commonwealth imposes a sales and use tax on a broad range of goods and services. The total tax imposed is 7% and is allocated as follows: 5.5% for the benefit of the Commonwealth (the "Commonwealth Sales Tax"), and 1.5% for the municipalities of the Commonwealth.

Act 91 established the Dedicated Sales Tax Fund, a special fund held and owned by the Corporation separate and apart from the Commonwealth's General Fund. Act 91 requires that the following amounts be deposited in the Dedicated Sales Tax Fund in each fiscal year, whichever is greater: (i) a minimum fixed amount, referred to as the Pledged Sales Tax Base Amount, and (ii) the product of the amount of the Commonwealth Sales Tax collected during such fiscal year multiplied by a fraction, the numerator of which is two point seventy-five percent (2.75%) and the denominator of which is the rate of the Commonwealth Sales Tax (the greater of (i) and (ii) being referred to as the Pledged Sales Tax). In each fiscal year, the first collections of the Commonwealth Sales Tax are deposited in the Dedicated Sales Tax Fund and applied to fund the Pledged Sales Tax Base Amount. The Pledged Sales Tax Base Amount for the fiscal year ended June 30, 2011, was $572,274,560. The Pledged Sales Tax Base Amount increases each fiscal year thereafter at a statutory rate of 4% up to $1,850,000,000. Under Act 91, the moneys on deposit in the Dedicated Sales Tax Fund may be used for the payment of the Corporation's bonds or satisfaction of the Authorized Uses (as defined below).

During 2009, the Legislative Assembly expanded the purposes of the Corporation. The Corporation is authorized to pay or finance, in whole or in part, or fund, in addition to the 2006 Appropriation Debt: (i) the debt of the Secretary of the Treasury of the Commonwealth (the "Secretary of the Treasury") with the Bank in the amount of $1 billion, a portion of the proceeds of which were used to cover the budgetary deficit of the Commonwealth for fiscal year 2009, (ii) certain financing granted to the Secretary of the Treasury by the Bank payable from future Commonwealth general obligation bonds, and any debt of the Commonwealth outstanding as of December 31, 2008, that did not have a source of repayment or was payable from budgetary appropriations, (iii) a portion of the accounts payable to suppliers of the Commonwealth, (iv) operational expenses of the Commonwealth for fiscal years 2009, 2010, and 2011, (v) operational expenses of the Commonwealth for fiscal year 2012, to the extent included in the annual budget of the Commonwealth, (vi) the Puerto Rico Economic Stimulus Fund, (vii) the Commonwealth Emergency Fund in order to cover expenses resulting from catastrophic events such as hurricanes or floods, and (viii) the Economic Cooperation and Public Employees Alternatives Fund (all such uses, together with the 2006 Appropriation Debt, the "Authorized Uses").

Regardless of the level of Commonwealth Sales Tax collections, Act 91 requires that in each fiscal year all collections of the Commonwealth Sales Tax be deposited in the Dedicated Sales Tax Fund until an amount equal to the Pledged Sales Tax Base Amount is deposited before any collections of Commonwealth Sales Tax are deposited in the Commonwealth's General 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 disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of changes in net assets during the reporting period. Actual results could differ from those estimates.

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

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

(a) Government-Wide and Fund Financial Statements:

Government-Wide Financial Statements — The statement of net deficit and the statement of activities report information on all activities of the Corporation. The Corporation's activities consist only of governmental activities. The effect of interfund balances has been removed from the statement of net deficit. Governmental activities are financed through revenue from the Commonwealth Sales Tax deposited in the Dedicated Sales Tax Fund and other financing sources.

The statement of net deficit presents the Corporation's assets and liabilities, with the difference reported as net deficit. Net assets (deficit) are reported in two categories:

- Restricted Net Assets — Result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

- Unrestricted Net Assets — Consist of net assets that do not meet the definition in the preceding category. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of activities demonstrates the degree to which direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues consist of investment earnings (including the change in fair value of investment derivatives) and the Pledged Sales Tax. Other items not meeting the definition of program revenues are reported as general revenues.

Governmental Fund's Financial Statements — Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. All funds of the Corporation are major funds.

(b) *Measurement Focus, Basis of Accounting and Financial Statement Presentation* — The accounts of the Corporation are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balances, revenue, and expenditures, as appropriate. Government resources are allocated to and accounted for in individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled.

Government-Wide Financial Statements — Government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Governmental Fund's Financial Statements — The governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become measurable and available.

Revenue resulting from the Commonwealth Sales Tax is recognized on an annual basis, upon collection or when the Commonwealth is obligated to make the payments. Interest income is recognized when earned, since it is available and measurable. Expenditures are recorded when the related liability is incurred. An exception to this general rule includes principal and interest on general long-term debt, which is recognized when due. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Corporation considers revenues to be available if they are collected within 30 days at the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred as under accrual accounting, except that interest on general long-term obligations is generally recognized when paid, and debt service principal expenditures and claims are recorded only when payment is due.

(c) *Fund Accounting* — The financial activities of the Corporation are recorded in individual funds, each of which is deemed to be a separate accounting entity. Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self balancing set of accounts. The financial activities of the Corporation that are reported in the accompanying basic financial statements have been classified into the following major governmental funds:

General Fund — The general fund of the Corporation is used to account for all financial resources, except those required to be accounted for in another fund.

Debt Service Fund — The debt service fund is used to account for the Commonwealth Sales Tax deposited in the Dedicated Sales Tax Fund for the payment of interest and principal on long-term obligations.

Fund balances for each governmental fund are displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- Non-spendable — amounts that cannot be spent because they are either not in a spendable form (such as inventories and prepaid amounts) or are legally or contractually required to be maintained intact.

- Restricted — amounts that can be spent only for specific purposes because of constraints imposed by external providers (such as grantors, bondholders, and higher levels of government), or imposed by constitutional provisions or enabling legislation.

- Committed — amounts that can be spent only for specific purposes determined by a formal action of the government's highest level of decision-making authority.

- Assigned — amounts the government intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed.

- Unassigned — amounts that are available for any purpose.

(d) Budgetary Accounting — The Corporation is not required to submit a budget for approval by the Legislative Assembly; consequently, no formal budgetary accounting procedures are followed.

(e) Investments and Investment Contracts — Investments and investment contracts are carried at fair value, except for money market instruments with a remaining maturity at the time of purchase of one year or less and investment positions in 2a7 (Securities and Exchange Commission Rule 2a7 of the Investment Company Act of 1940) like external investment pools, which are carried at cost or the pool's share price. Fair value is determined based on quoted market prices.

(f) Restricted Assets — Certain resources are set aside for the repayment of bonds payable or for the Authorized Uses. These assets are generally classified as restricted assets on the accompanying Statement of Net Deficit, except when liabilities exceed assets, in which case the excess is classified as unrestricted.

(g) Deferred Bond Issue Costs and Premium/Discount on Bonds — Deferred bond issue costs and premium/discounts on bonds are amortized on a systematic manner over the life of the debt in the government-wide financial statements. Deferred bond issue costs and premium/discounts are recognized in the period when the related long-term debt is issued in the governmental funds financial statements, and therefore are not accounted for in subsequent periods.

(h) Inter-Fund Transactions — The Corporation has operating transfers which are legally required transfers that are reported when incurred as "Transfers-in" by the recipient fund and as "Transfers-out" by the disbursing fund.

(i) Refundings — Refundings involve the issuance of new debt whose proceeds are used to repay immediately (current refunding) or at a future time (advance refunding) previously issued debt. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is recorded on the statement of net deficit as an addition to or deduction from the new debt.

(j) Deferred Revenue — Deferred revenue represents resources that do not yet meet the criteria for revenue recognition.

The Corporation follows GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. This statement provides that derivative instruments, with the exception of synthetic guaranteed investment contracts that are fully benefit-responsive, are reported at fair value. The changes in fair value of derivative instruments that are classified as hedging derivative instruments are reported in the statement of net assets as deferrals. The changes in fair value of derivative instruments that are used for investment purposes or that are reported as investment derivative instruments because of ineffectiveness are reported within the investment revenue classification.

Derivative instruments associated with hedgeable items that are determined to be effective in reducing exposures to identified financial risks are considered hedging derivative instruments. Effectiveness is determined by considering whether the changes in cash flows or fair values of the potential hedging derivative instrument substantially offset the changes in cash flows or fair values of the hedgeable item. This statement describes the methods of evaluating effectiveness. If the derivative is effective, hedge accounting is applied. Under hedge accounting, the changes in fair values of the hedging derivative instrument are reported as either deferred inflows or deferred outflows in the Corporation's statement of net assets.

This statement also provides disclosures required for derivative instruments. The objectives, terms, and risks of hedging derivative instruments are required disclosures. Disclosures also include a summary of derivative instrument activity that provides an indication of the location of fair value amounts reported on the financial statements. The disclosures for investment derivative instruments are similar to the disclosures of other investments.

Future Adoption of Accounting Pronouncements — The GASB has issued the following Statements:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employers Plans*, which is effective for periods beginning after June 15, 2011.

- GASB Statement No. 60, *According and Financial Reporting for Service Concession Arrangements*, which is effective for periods beginning after December 15, 2011.

- GASB Statements No. 61, *The Financial Reporting Entity: Omnibus – and amendment of GASB Statements No. 14 and No. 34*, which is effective for periods beginning after June 15, 2012.

- GASB Statements No. 62, *Codification of Accounting and Financial Reporting Guidance contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which is effective for periods beginning after December 15, 2011.

- GASB Statements No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, which is effective for periods beginning after December 15, 2011.

- GASB Statements No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions— an amendments of GASB Statement No. 53*, which is effective for periods beginning after June 15, 2011.

Management is evaluating the impact that these statements will have on the Corporation's basic financial statements.

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the Corporation's deposit may not be returned to it. The Corporation does not have a deposit policy for custodial credit risk. As of June 30, 2011, all of the Corporation's bank balance, aggregating to approximately $373,143,000, which equals the book balance, was exposed to custodial credit risk since such deposits, all of which are maintained at the Bank, are uninsured and uncollateralized.

4. TRANSACTIONS WITH THE GOVERNMENT DEVELOPMENT BANK OF PUERTO RICO, AND THE COMMONWEALTH

The Corporation is an affiliate of the Bank. During the year ended June 30, 2011, the Bank provided certain management and administrative services to the Corporation at no cost.

In accordance with Act 91, the Corporation made payments to the Commonwealth and its agencies and instrumentalities or on their behalf amounting to approximately $1.6 billion for Authorized Uses.

5. INVESTMENTS AND INVESTMENT CONTRACTS

In accordance with investment guidelines promulgated by the Bank for agencies and public corporations of the Commonwealth under the authority provided by Act No. 113 of August 3, 1995, and Executive Order 1995-50A (the "investment guidelines"), the Corporation is authorized to purchase or enter into the following investment instruments:

- U.S. Government and Agencies Obligations
- Certificates of deposit
- Bankers acceptances
- Commercial paper
- Participations in the Puerto Rico Government Investment Trust Fund (PRGITF)
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Obligations of state and local governments of the United States of America
- Mortgage and asset-backed securities
- Corporate debt, including investment contracts
- External investment pools

The investment guidelines also establish limitations and other guidelines.

Investments held by the debt service fund are purchased following the provisions of the related trust indenture.

The following table summarizes the type and maturities of investments held by the Corporation at June 30, 2011. Investments by type in any one issuer representing 5% or more of total investments have been separately disclosed.

Investment Type		Due within One Year
U.S. Treasury bills	$	258,155,248
U.S. Treasury State & Local Government Series (SLGs)		96,330,279
Corporate debt — General Electric Capital Corp.		31,011,000
External investment pools:		
Dreyfus Government Cash Management		102,658,873
Puerto Rico Government Investment Trust Fund (PRGITF)		157,426,683
Total investments	$	645,582,083

Investments in external investments pools consist of $157,426,683 invested in PRGITF, an internal investment pool of the Commonwealth, and $102,658,873 invested in Dreyfus Government Cash Management (Dreyfus) with the Bank of New York Mellon, which is an investment pool registered with the Securities and Exchange Commission.

Investments in U.S. Treasury bills and U.S. Treasury SLGs carry the explicit guarantee of the U.S. government. As of June 30, 2011, the credit rating of PRGITF, Dreyfus and General Electric Capital Corp. (GE) was AAA, AAAm, and A1+, respectively, by Standard & Poor's. The investment in PRGITF was held by the Corporation, while the investments in Dreyfus and GE were held by Bank of New York Mellon, as trustee, in the name of the Corporation.

As of June 30, 2011, investments in PRGITF and Dreyfus amounting to approximately $260 million will be used to fund Authorized Uses and, accordingly, have been presented as a restricted investment in the statement of net deficit.

6. BONDS PAYABLE

On June 23, 2011, the Corporation issued its Sales Tax Revenue Bonds, Junior Subordinate Series 2011A amounting to approximately $327.5 million. The Junior Subordinate Series 2011A bonds represent capital appreciation bonds which mature between August 1, 2043 and August 1, 2050 on which interest is capitalized at an annual rate of 7.00% each February 1 and August 1 until maturity. The proceeds from the issuance of the Series 2011A bonds were deposited in an interest-bearing deposit account with the Bank and will be used to pay operational expenses of the Commonwealth for fiscal years 2011 and 2012.

As of June 30 2011, bonds payable of the Corporation consist of the following (in thousands):

Description	Face/Effective Interest Rate	Amount
Sales Tax Revenue Bonds, Series 2007A:		
Capital Appreciation Bonds due from August 1, 2040 to August 1, 2056	4.96%–5.34%	$ 2,031,812
Fixed Rate Bonds due on August 1, 2057, including unamortized premium of $15,161	5.25%	579,046
LIBOR-Based Adjustable Rate Bonds due on August 1, 2057	1.11%	136,000
Sales Tax Revenue Bonds, Series 2007B:		
Capital Appreciation Bonds due from August 1, 2027 to August 1, 2032	6.20%–6.25%	187,110
Fixed Rate Bonds due from August 1, 2033 to August 1, 2057 — net of unaccreted discount of $2,713, including unamortized refunding gain of $109,763	6.05%–6.35%	1,293,050
Sales Tax Revenue Bonds, Series 2007C:		
Capital Appreciation Bonds due from August 1, 2022 to August 1, 2038	6.10%	104,720
Term Bonds due from August 1, 2022 to August 1, 2038	6.00%	415,305
Sales Tax Revenue Bonds, Series 2008A:		
Capital Appreciation Bonds due from August 1, 2024 to August 1, 2036	6.23%	298,602
Term Bonds due from August 1, 2027 to August 1, 2038	6.13%	488,885
Sales Tax Revenue Bonds, First Subordinate Series 2009A:		
Fixed Rate Bonds due from August 1, 2015 to August 1, 2029, including unamortized premium of $14,289 and net of unaccreted discount of $14,052	3.75%–6.13%	1,121,387
Term Bonds due from August 1, 2036 to August 1, 2044, including unamortized premium of $15,702 and net of unaccreted discount of $47,307	5.75%–6.50%	1,783,395
Capital Appreciation Bonds due from August 1, 2030 to August 1, 2034	6.88%–7.13%	160,267
Convertible Capital Appreciation Bonds due on August 1, 2030 to August 1, 2032 (1)	6.75%	392,527
Sales Tax Revenue Bonds, First Subordinate Series 2009B:		
Fixed Rate Bonds due from August 1, 2025 to August 1, 2039	6.05%–6.35%	957,410
Capital Appreciation Bonds due from August 1, 2033 to August 1, 2035	7.38% to 7.48%	62,068
Convertible Capital Appreciation Bonds due from August 1, 2025 to August 1, 2031 (2)	6.90%–7.00%	237,570
Sales Tax Revenue Bonds, First Subordinate Series 2009C — Fixed Rate Bonds due on August 1, 2057, net of unamortized refunding loss of $38,528	5.75%	199,347
Sales Tax Revenue Bonds, First Subordinate Series 2010A:		
Fixed Rate Bonds due from August 1, 2016 to August 1, 2040, including unamortized premium of $1,308 and net of unaccreted discount of $2,508	3.38%–5.63%	305,410
Term Bonds due from August 1, 2036 to August 1, 2042 — net of unaccreted discount of $24,285	5.38%–5.50%	1,213,055
Capital Appreciation Bonds due from August 1, 2031 to August 1, 2036	6.65%–6.77%	142,388
Convertible Capital Appreciation Bonds due on August 1, 2029 to August 1, 2033 (3)	6.13%–6.25%	163,380
Sales Tax Revenue Bonds, First Subordinate Series 2010C:		
Fixed Rate Bonds due from August 1, 2035 to August 1, 2042, including unamortized premium of $15,260 and net of unaccreted discount of $801	5.13%–6.50%	462,119
Term Bonds due from August 1, 2033 to August 1, 2041 — net of unaccreted discount of $24,214	5.00%–5.50%	1,049,811
Capital Appreciation Bonds due from August 1, 2037 to August 1, 2039	6.63%	104,335
Sales Tax Revenue Bonds, First Subordinate Series 2010D — Fixed Rate Bonds due on August 1, 2042	5.75%	89,435
Sales Tax Revenue Bonds, First Subordinate Series 2010E — Fixed Rate Bonds due on August 1, 2042	5.75%	92,755
Sales Tax Revenue Bonds, Junior Subordinate Series 2011A — Capital Appreciation Bonds due from August 1, 2043 to August 1, 2050	7.00%	328,021
Bonds payable — net		$ 14,399,210

(1) Convertible to fixed-rate interest bonds on August 1, 2016.

(2) Convertible to fixed-rate interest bonds on August 1, 2016 and August 1, 2020 for bonds maturing on August 1, 2030 and 2031.

(3) Convertible to fixed-rate interest bonds on August 1, 2019.

Bonds payable activity for the year ended June 30, 2011 is as follows (in thousands):

Description	Balance at June 30, 2010	Issuances	Other Increases	Reductions	Payments	Balance at June 30, 2011
Bonds payable	$13,837,783	$ 327,512	$ 216,840	$ -	$ -	$14,382,135
Less:						
Unamortized bond premium (discount)	(54,572)			412		(54,160)
Refunding loss	(39,899)			1,371		(38,528)
Refunding gain	112,143			(2,380)		109,763
Bonds and note payable — net	$13,855,455	$ 327,512	$ 216,840	$ (597)	$ -	$14,399,210

No principal payments of bonds and note payable are due within one year.

As of June 30, 2011, debt service requirements for bonds outstanding were as follows:

Year Ending June 30	Principal	Interest	Interest Subsidy (1)	Total
2012	$ -	$ 577,400,961	$ (4,199,915)	573,201,046
2013		577,400,961	(4,199,915)	573,201,046
2014		577,400,961	(4,199,915)	573,201,046
2015		577,400,961	(4,199,915)	573,201,046
2016	11,300,000	577,189,086	(4,199,915)	584,289,171
2017–2021	327,150,000	3,115,744,304	(20,999,575)	3,421,894,729
2022–2026	773,285,000	3,143,964,407	(20,999,575)	3,896,249,832
2027–2031	2,292,210,000	2,812,743,604	(20,999,575)	5,083,954,029
2032–2036	3,922,631,000	2,285,119,121	(20,999,575)	6,186,750,546
2037–2041	5,061,270,000	1,487,809,974	(20,999,575)	6,528,080,399
2042–2046	7,014,000,000	461,769,569	(5,249,894)	7,470,519,675
2047–2051	6,462,596,438	287,476,663		6,750,073,101
2052–2056	5,090,169,809	287,476,663		5,377,646,472
2057–2058	2,289,035,000	80,043,776		2,369,078,776
	33,243,647,247	$16,848,941,011	$ (131,247,344)	$49,961,340,914
Plus (less):				
Unamortized premium	61,719,343			
Unaccreted discount	(115,878,967)			
Deferred refunding gain	109,763,216			
Deferred refunding loss	(38,528,321)			
Unaccreted interest	(18,861,512,701)			
Bonds payable – net	$ 14,399,209,817			

(1) Sales Tax Revenue Bonds, First Subordinate Series 2010D and 2010E were issued as Build America Bonds. The Corporation will receive a subsidy payment from the federal government equal to 35% and 45%, respectively, of the amount of each interest payment.

At June 30, 2011, the Corporation has $136,000,000 of LIBOR based adjustable rate bonds maturing on August 1, 2057. As explained below, the Corporation has entered into a $136,000,000 interest rate swap, whereby it receives the same rate paid on the adjustable rate bonds and pays a fixed rate of 4.92% through August 1, 2057. Accordingly, the Corporation has synthetically fixed the interest rate on the adjustable rate bonds. Assuming the rate effective as of June 30, 2011 remains the same, debt service requirements for the adjustable rate bonds and net swap payments for their term, are as follows:

Year Ending	**Adjustable- Rate Bonds**		**Interest Rate**	
June 30	**Principal**	**Interest**	**Swaps, Net**	**Total**
2012	$ -	$ 1,513,558	$ 5,177,642	$ 6,691,200
2013		1,513,558	5,177,642	6,691,200
2014		1,513,558	5,177,642	6,691,200
2015		1,513,558	5,177,642	6,691,200
2016		1,513,558	5,177,642	6,691,200
2017 - 2021		7,567,788	25,888,212	33,456,000
2022 - 2026		7,567,788	25,888,212	33,456,000
2027 - 2031		7,567,788	25,888,212	33,456,000
2032 - 2036		7,567,788	25,888,212	33,456,000
2037 - 2041		7,567,788	25,888,212	33,456,000
2042 - 2046		7,567,788	25,888,212	33,456,000
2047 - 2051		7,567,788	25,888,212	33,456,000
2052 - 2056		7,567,788	25,888,212	33,456,000
2057 - 2058	136,000,000	1,891,947	8,144,853	146,036,800
Total	$ 136,000,000	$ 70,002,041	$ 241,138,759	$ 447,140,800

The Corporation's outstanding bonds are payable from amounts deposited in the Dedicated Sales Tax Fund in each fiscal year. The minimum amount to be deposited is the Pledged Sales Tax Base Amount, which for the fiscal year ended June 30, 2011, was $572,274,560. The Pledged Sales Tax Base Amount increases each fiscal year at a statutory rate of 4% up to $1,850,000,000. At June 30, 2011, the Pledged Sales Tax Base Amount, by year, is as follows:

Year Ending June 30	**Amount**
2012	$ 595,165,542
2013	618,972,164
2014	643,731,051
2015	669,480,293
2016	696,259,504
2017 - 2021	3,922,012,704
2022 - 2026	4,771,728,139
2027 - 2031	5,805,536,890
2032 - 2036	7,063,323,307
2037 - 2041	8,587,498,919
2042 - 2046	9,250,000,000
2047 - 2051	9,250,000,000
2052 - 2056	9,250,000,000
2057 - 2058	3,700,000,000
	$ 64,823,708,513

7. DERIVATIVE INSTRUMENTS

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Corporation exposes itself to interest rate risk, credit risk, and termination risk.

Interest rate risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The Corporation is exposed to interest rate risk on its pay-fixed, receive-variable swap; as LIBOR decreases, the Corporation's net payment on the swap increases. At the same time, interest payments on the hedged adjustable rate bonds decrease. The interest rate risk associated with interest rate swap contracts is managed by establishing and monitoring parameters that limit the types and degree of interest rate risk that may be undertaken.

Credit risk is the failure of the counterparty (or its guarantor) to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Corporation, which creates credit risk for the Corporation. When the fair value of a derivative contract is negative, the Corporation owes the counterparty and, therefore, does not possess credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with counterparties whose credit rating is acceptable under the investment policies of the Corporation.

Termination risk is the possibility that a hedging derivative instrument's unscheduled end will affect the Corporation's liability strategy or will present the Corporation with potentially significant unscheduled termination payments to the counterparty. The Corporation or its counterparties may terminate a derivative instrument if the other party fails to perform under the terms of the contract. The Corporation is at risk that counterparty will terminate a swap at a time when the Corporation owes it a termination payment. The Corporation has mitigated this risk by specifying that the counterparty has the right to terminate only as a result of certain events, including: a payment default by the Corporation; insolvency of the Corporation (or similar events); or a downgrade of the Corporation's credit rating below BBB+ or Baa1. If at the time of termination, an investment derivative instrument is in a liability position, the Corporation would be liable to the counterparty for a payment equal to the liability, subject to netting arrangements.

The Corporation has entered into an interest rate exchange agreement (swap) with a counterparty in connection with the issuance of LIBOR-Based Adjustable Rate Bonds within the Sales Tax Revenue Bonds Series 2007A (the "Adjustable Rate Bonds"). The Adjustable Rate Bonds expose the Corporation to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of interest payments on the Adjustable Rate Bonds. To meet this objective, management entered into an interest rate swap agreement to manage fluctuations in cash flows resulting from interest rate risk. This swap effectively changes the variable rate cash flow exposure on the Adjustable Rate Bonds to fixed cash flows. Under the terms of the interest rate swap, the Corporation receives variable interest rate payments equal to the interest payment on the Adjustable Rate Bonds, and makes fixed interest rate payments, thereby creating the equivalent of a fixed rate debt. At June 30, 2011, the credit rating of the counterparty to this swap agreement was A by Standard & Poor's.

The Corporation is also a party to two forward swap agreements, both with effective date on February 1, 2012, in an aggregate notional amount of $907 million. The Corporation entered into these forward swap agreements in connection with the expected issuance of variable rate bonds, the proceeds of which are to be used to repay certain mandatory tender bonds issued by PFC. Pursuant to the terms of the agreements, on the effective date, the Corporation will pay a fixed interest rate of 3.95%, and will receive 67% of the three month LIBOR until its maturity on August 1, 2040. The recent U.S. financial market crisis has resulted in a significant reduction in the availability of credit/liquidity facilities to support variable rate bonds, and a related increase in the price of these facilities when they can be obtained. As a result, the occurrence of this expected transaction is not deemed probable and, accordingly, these forward swap agreements have been classified as investment derivative instruments. At June 30, 2011, the credit ratings of the counterparties to these forward swap agreements were A and BBB by Standard & Poor's.

The fair values and notional amounts of derivative instruments outstanding at June 30, 2011, classified by type, are as follows:

Notional Amount	Fair Value	Change in Fair Value	Floating Rate Indicator	Rate at June 30, 2010			
(In thousands)				Receives		Pays	
				Type	Rate	Type	Rate
Hedging Derivative Instrument:							
$136,000	$ 37,222	$ 9,832	67% of 3m LIBOR plus .93	Variable	1.113 %	Fixed	4.920 %
Investment Derivative Instruments:							
$453,500	$ 84,877	$ 12,882	67% of 3m LIBOR	Variable	TBD	Fixed	3.950 %
453,500	88,626	9,528	67% of 3m LIBOR	Variable	TBD	Fixed	3.950 %
$907,000	$173,503	$ 22,410					

TBD - To be determined at effective date.

The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

8. CONTINGENCY

In connection with the termination of an interest rate exchange agreement ("swap") with a notional amount of $218 million by the Corporation relating to its Sales Tax Revenue Bonds, Series 2007 A, the Corporation made a termination payment to the counterparty in November 2008. The counterparty has asserted that it is entitled to a termination payment in excess of that paid by the Corporation in November 2008, plus interest at a default rate, amounting to approximately $25 million. The counterparty alleges that the date of the termination notice used by the Corporation for purposes of calculating the termination payment was not in accordance with the agreement. In addition, the counterparty alleges that the termination payment should have been based on the value of replacement swaps entered into by the Corporation, which actually have different credit terms than those contained in the terminated swap.

The Corporation has accrued $3.4 million to cover for any unfavorable outcome at June 30, 2011. This amount is presented within accounts payable and other in the accompanying statement of net deficit. The amount claimed in excess of that accrued at year end is approximately $21.6 million. An amount of possible loss in excess of the $3.4 million accrued, if any, cannot be reasonably estimated. However, it is the opinion of the Corporation's management that this claim is unfounded and intends to contest the matter vigorously. Management does not expect that the ultimate costs to resolve this matter will have a material adverse effect on its financial position or results of operations.

9. SUBSEQUENT EVENTS

Subsequent events were evaluated through April 30, 2012, the date the financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the 2011 financial statements.

On November 23, 2011, the Corporation issued its Sales Tax Revenue Bonds, First Subordinate Series 2011A amounting to approximately $734.8 million. The Series 2011A bonds mature between August 1, 2023 and August 1, 2050 bearing interest rates from 5.00% to 7.00%. The proceeds from the issuance of the Series 2011A bonds will be mainly used to refund certain outstanding bonds of the Corporation and provide funds to the Commonwealth to cover operating expenses of the Commonwealth. In addition, the Corporation issued its Sales Tax Revenue Bonds, First Subordinate Series 2011B amounting to approximately $45.6 million. The Series 2011B matures between August 1, 2031 and August 1, 2036 bearing fixed interest rates from 5.00% to 5.15%. The proceeds from the issuance of the Series 2011B bonds will be mainly used to refund certain outstanding bonds of the Corporation.

On December 13, 2011, the Corporation issued its Sales Tax Revenue Bonds, Senior Series 2011C amounting to approximately $1,006.5 million. The Series 2011C bonds mature between August 1, 2020 and August 1, 2046 bearing interest rates from 4.00% to 6.25%. The proceeds from the issuance of the Series 2011C bonds will be mainly used to refund certain outstanding bonds of the Puerto Rico Public Finance Corporation and cover certain payments associated with swap agreements of the Corporation. In addition, the Corporation issued its Sales Tax Revenue Bonds, Senior Series 2011D amounting to approximately $91.1 million. The Series 2011D bonds mature between August 1, 2023 and August 1, 2036 bearing interest rates from 3.80% to 4.85%. The proceeds from the issuance of the Series 2011D bonds will be mainly used to refund certain outstanding bonds of the Puerto Rico Public Finance Corporation.

* * * * * *