



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

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

AUDITED FINANCIAL STATEMENTS AND
YEARS ENDED JUNE 30, 2009 AND 2008

400 Américo Mirapda Ave.
Cesvi Building 3rd Floor
San Juan, PR 00926

📞 787.622.0029
📞 787.622.0019
🌐 www.guzmantorres.com

PUERTO RICO METROPOLITAN BUS AUTHORITY

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying statements of net assets of Puerto Rico Metropolitan Bus Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of June 30, 2009, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits. The financial statements of the Authority as of and for the year ended June 30, 2008, were audited by other auditors whose opinion dated April 15, 2009 expressed an unqualified opinion on those statements. As discussed in Note 12, the Authority has restated its 2008 financial statements during the current year to properly reflect the balance of transportation equipment and related accumulated depreciation. The other auditors reported on the 2008 financial statements before the restatement.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 2009 financial statements referred to above present fairly, in all material respects, the financial position of Puerto Rico Metropolitan Bus Authority at June 30, 2009 and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

We also audited the adjustments described in Note 12 that were applied to restate the 2008 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

The management's discussion and analysis information on pages 3 through 9 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

As described in Note 11 to the financial statements, the Authority received operating assistance from the Commonwealth of Puerto Rico to assist in the financing of the Authority's operations. The amount of such assistance indicates that the Authority may require continued assistance in order to operate at its current level as a going concern.

Guzmán Torres & Co., P.S.C.

CERTIFIED PUBLIC ACCOUNTANTS
March 12, 2010

Stamp # 2505877
was affixed to
the original of
this report.

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

MANAGEMENT DISCUSSION AND ANALYSIS
YEARS ENDED JUNE 30, 2009 AND 2008

The following discussion and analysis of the financial performance and activity of the Puerto Rico Metropolitan Bus Authority ("the Authority") provides an introduction and understanding of the basic financial statements of the Authority for the fiscal years ended June 30, 2009 and 2008. This discussion was prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Financial Highlights for 2009

- Net assets deficiency totaled \$19.6 million at June 30, 2009.
- Net assets deficiency increased by \$21.5 million in 2009, as compared to a decrease in of approximately \$.6 million in 2008.
- Net capital assets totaled \$51.5 million at June 30, 2009
- Net capital assets decreased by 12% at June 30, 2009, when compared with the balance at June 30, 2008 of \$58.7 million.

Financial Highlights for 2008 (as restated)

- Net assets efficiency totaled \$1.9 million at June 30, 2008.
- Net assets decreased by \$.6 million in 2008, as compared to a decrease of \$11.3 million in 2007.
- Net capital assets totaled \$58.7 million at June 30, 2008
- Net capital assets decreased by 9% at June 30, 2008, when compared with the balance at June 30, 2007 of \$53.6 million.

The Financial Statements

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

During the year ended June 30, 2009 the Authority evaluated its accounting records and found that cost of transportation equipment and its related accumulated depreciation were not properly reflected in prior years issued financial statements. The effect of this adjustment was to increase the deficiency in net assets as of July 1, 2007 by approximately \$5,252,000 and to reduce the depreciation expense during the year ended June 30, 2008 by approximately \$466,000 and a related decrease in the net book value of transportation equipment at June 30, 2008 of \$4,786,000.

Financial analysis in this section is made considering the effect of the above adjustment.

Overview of the Financial Statements for Business-Type Activities

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

Statement of Net Assets

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

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

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

Statement of Revenues, Expenses, and Changes in Net Assets

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

Statement of Cash Flows

The statement of cash flows discloses net cash provided by or used for operating activities, investing activities, noncapital financing activities, and from capital and related financing

activities. This statement also portrays the health of the Authority in that current cash flows are sufficient to pay current liabilities.

Notes to Financial Statements

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

Financial Analysis of the Authority's Business-Type Activities

Statements of Net Assets

The following table reflects a condensed summary of assets, liabilities, and net assets of the Authority as of June 30, 2009, 2008, and 2007:

	<u>2009</u>	<u>June 30, 2008</u>	<u>2007</u>
		<i>As Restated</i>	<i>As Restated</i>
ASSETS			
Current assets	\$ 10,712,321	\$ 21,785,936	\$ 16,371,956
Capital assets	51,519,173	58,688,677	53,624,553
Other assets	<u>267,071</u>	<u>267,886</u>	<u>267,071</u>
Total assets	<u>\$ 62,498,565</u>	<u>\$ 80,742,499</u>	<u>\$ 70,263,580</u>
LIABILITIES			
Current liabilities	\$ 44,656,321	\$ 39,719,492	\$ 21,220,272
Long-term liabilities	<u>37,409,974</u>	<u>39,129,982</u>	<u>46,490,205</u>
Total liabilities	<u>82,066,295</u>	<u>78,849,474</u>	<u>67,710,477</u>
NET ASSETS			
Invested in capital assets, net of related debt	51,519,173	58,688,677	53,624,553
Deficiency in unrestricted net assets	<u>(71,086,903)</u>	<u>(56,795,652)</u>	<u>(51,071,450)</u>
Total net assets	<u>(19,567,730)</u>	<u>1,893,025</u>	<u>2,553,103</u>
Total liabilities and net assets	<u>\$ 62,498,565</u>	<u>\$ 80,742,499</u>	<u>\$ 70,263,580</u>

June 30, 2009

Current assets decreased by 51% to \$10.7 million. The change in current assets is primarily due to a decrease in cash and cash equivalents and in capital contributions receivable.

Capital assets decreased by 12% to \$51.5 million due to retirement and disposition of transportation equipment that reached the end of their useful life. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the Federal Transit Administration which is used to finance the capital improvement program. Total capital grants received from the Ports Authority during fiscal year 2009 amounted to approximately \$14.1 million.

Current liabilities increased by 11% to \$44.7 million. This increase consists principally of an increase in accrued expenses payable.

Long-Term Debt consists principally of amounts due to Scotia Bank of Puerto Rico related to a long-term financing obtained in prior years. The loan with Scotia Bank is payable in monthly principal installment of \$143,334 plus interests at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2009) due in February 12, 2012.

Net assets decreased to deficiency of by 1,134% to a net deficiency of \$19.6 million. This decrease was the result of an excess of expenses (operating and non-operating) over revenues (operating and non-operating) and capital grants of \$21.8 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

June 30, 2008

Current assets increased by 33% to \$21.8 million. The change in current assets is primarily due to an increase in cash and cash equivalents and federal government appropriations.

Capital assets increased by 9.4% to \$58.7 due to capital assets acquired during the year net of related depreciation expense. Capital assets are funded with the proceeds from operations and operating and capital grants from the Commonwealth of Puerto Rico. In addition, the Authority is a recipient of certain funds under Federal program 20.507 "Urban Mass Transportation Capital and Operating Assistance Formula Grant" granted by the Federal Transit Administration which is used to finance the capital improvement program. Total capital grants received from the Ports Authority during fiscal year 2008 amounted to approximately \$22.3 million.

Current liabilities increased by 87% to \$39.7 million due principally to an increase in accounts payable and accrued expenses.

Long-Term Debt consists principally of amounts due to Scotia Bank of Puerto Rico related to a long-term financing obtained in prior years. The loan with Scotia Bank is payable in monthly principal installment of \$143,334 plus interests at fixed rate of 5.43% plus a spread as defined in the loan agreement (6.68% at June 30, 2008) due in February 12, 2012.

Net assets decreased by 25.8% to \$1.9 million. This decrease was the result of an excess of expenses (operating and non-operating) over revenues (operating and non-operating) and capital grants of \$.6 million. The largest portion of the Authority's net assets represents its investment in capital assets net of related debt outstanding used to acquire those capital assets.

The following table reflects a condensed summary of the revenues, expenses, and changes in net assets for the three years ended June 30, 2009:

	Years Ended June 30,		
	2009	2008 <i>As Restated</i>	2007 <i>As Restated</i>
Operating revenues	\$ 24,403,044	\$ 31,535,689	\$ 31,665,368
Operating expenses	85,542,546	85,353,134	81,083,657
Operating loss	<u>(61,139,502)</u>	<u>(53,817,445)</u>	<u>(49,418,289)</u>
Non-operating revenues:			
Operating grants	42,193,592	46,863,505	26,760,617
Interest income (expense), net	<u>(5,014,845)</u>	<u>(3,931,421)</u>	<u>(1,979,350)</u>
Total non-operating revenues	<u>37,178,747</u>	<u>42,932,084</u>	<u>24,781,297</u>
Loss before capital contributions	(23,960,755)	(10,885,361)	(24,636,992)
Capital contributions	2,500,000	10,225,283	13,262,226
Change in net assets	<u>(21,460,755)</u>	<u>(660,078)</u>	<u>(11,374,766)</u>
Net assets deficit at beginning of year			
As previously reported	6,679,201	7,805,086	19,179,852
Adjustment to prior year issued financial statements	<u>(4,786,176)</u>	<u>(5,251,983)</u>	<u>(5,251,983)</u>
As restated	<u>1,893,025</u>	<u>2,553,103</u>	<u>13,927,869</u>
Net assets deficit at end of year	<u>\$ (19,567,730)</u>	<u>\$ 1,893,025</u>	<u>\$ 2,553,103</u>

Year Ended June 30, 2009

Operating revenues which consisted principally of fares for transportation and other services, decreased by 23% to \$24.4 million. This decrease is due to a decrease in patronage during fiscal year 2009 as a result of general economic conditions. The Authority had a service contract with the Puerto Rico Highways and Transportation Authority (PRHTA) in which PRHTA paid the Authority a total of \$23,200,000 for certain transportation services during the year ended June 30, 2008. This contract was cancelled effective February 2009. The amount received by the Authority under this contract during the year ended June 30, 2009 amounted to \$13,654,545.

Operating expenses, which consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased by 0.22% to \$85.5 million.

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

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

Year Ended June 30, 2008

Operating revenues consisted of fares for transportation and other services and service contract with the Puerto Rico Highways and Transportation Authority (PRHTA). These revenues decreased by .41% to \$31.5 million. This decrease is due to a decrease in patronage during fiscal year 2008 as a result of general economic conditions. The Authority had a service contract with PRHTA in which PRHTA paid the Authority a total of \$23,200,000 for certain transportation services.

Operating expenses, which consisted principally of salaries and employees benefits, depreciation and amortization, repairs and maintenance, diesel, insurance, professional services and general and administrative increased by 5.2% to \$85.4 million mainly due to an increase in salaries and employees benefits, oil and diesel and depreciation.

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

In addition the Authority receives operating and capital contributions from the U.S. Department of Transportation which are restricted to the acquisition and repairs of certain capital assets.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2009, the Authority had invested approximately \$51.5 million in capital assets (net of related depreciation) including transportation equipment, land and buildings and machinery and equipment used in the operations. At June 30, 2008, the Authority had invested approximately \$58.7 million in capital assets.

Major capital assets events during the years ended June 30, 2009 and 2008 include the acquisition and repairs of transportation equipment which were funded principally by capital contributions received.

Debt Administration

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

In addition a long-term note payable with the same commercial bank payable in monthly principal installment of \$143,334 plus a fixed interest rate of 5.43% plus a spread as defined in the loan agreement. A balloon payment for the principal amount outstanding is due on February 2012.

CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

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

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

STATEMENTS OF NET ASSETS
 JUNE 30, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
		<i>As Restated</i>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 1,169,682	\$ 4,364,286
Accounts receivable	3,416,436	10,787,205
Inventory	3,671,850	3,913,594
Prepaid expenses	<u>2,454,353</u>	<u>2,720,851</u>
Total current assets	10,712,321	21,785,936
CAPITAL ASSETS	51,519,173	58,688,677
OTHER ASSETS	<u>267,071</u>	<u>267,886</u>
TOTAL	<u>\$ 62,498,565</u>	<u>\$ 80,742,499</u>
LIABILITIES AND NET ASSETS (DEFICIT)		
CURRENT LIABILITIES:		
Borrowings under line of credit	\$ 3,000,000	\$ 3,000,000
Accounts payable	13,509,957	16,376,747
Accrued expenses payable	24,207,141	18,430,394
Deferred revenue	2,219,215	192,343
Current portion of long-term debt	<u>1,720,008</u>	<u>1,720,008</u>
Total current liabilities	<u>44,656,321</u>	<u>39,719,492</u>
LONG-TERM DEBT		
Notes payable, net of current portion	<u>37,409,974</u>	<u>39,129,982</u>
NET ASSETS (DEFICIT):		
Invested in capital assets, net of related debt	51,519,173	58,688,677
Unrestricted deficit	<u>(71,086,903)</u>	<u>(56,795,652)</u>
Net assets (deficit)	<u>(19,567,730)</u>	<u>1,893,025</u>
TOTAL	<u>\$ 62,498,565</u>	<u>\$ 80,742,499</u>

The accompanying notes are integral part of the financial statements

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
		<i>As Restated</i>
OPERATING REVENUES		
Passenger fares	\$ 10,120,615	\$ 7,541,995
Service contract with Puerto Rico Highways and Transportation Authority	13,654,545	23,200,000
Advertising and other	627,884	793,694
Total operating revenues	<u>24,403,044</u>	<u>31,535,689</u>
OPERATING EXPENSES		
Salaries and employee benefits	57,428,968	56,246,760
Diesel, gasoline, oil and lubricants	6,266,897	6,723,021
Depreciation and amortization	9,675,690	8,118,120
Materials, spare parts and repairs and maintenance	5,912,733	4,140,570
Utilities	1,607,215	1,441,309
Professional services	2,208,325	1,918,506
General and administrative	2,442,718	6,764,848
Total operating expenses	<u>85,542,546</u>	<u>85,353,134</u>
OPERATING LOSS	<u>(61,139,502)</u>	<u>(53,817,445)</u>
NON-OPERATING REVENUES (EXPENSES)		
Gasoline, diesel, petroleum and tax oil revenues	8,777,138	26,703,638
Operating grants:		
Commonwealth of Puerto Rico operating grant	19,277,374	8,024,447
Federal Government	14,139,080	12,135,420
Interest and other financing expenses	(5,041,703)	(3,979,756)
Interest income	26,858	48,335
Total non-operating revenues	<u>37,178,747</u>	<u>42,932,084</u>
LOSS BEFORE CAPITAL CONTRIBUTIONS	<u>(23,960,755)</u>	<u>(10,885,361)</u>
CAPITAL CONTRIBUTIONS	<u>2,500,000</u>	<u>10,225,283</u>
CHANGE IN NET ASSETS	<u>(21,460,755)</u>	<u>(660,078)</u>
NET ASSETS AT BEGINNING OF YEAR:		
As previously reported	6,679,201	7,805,086
Adjustment to prior year issue financial statements	(4,786,176)	(5,251,983)
As restated	<u>1,893,025</u>	<u>2,553,103</u>
NET ASSETS (DEFICIENCY), AT END OF YEAR	<u>\$ (19,567,730)</u>	<u>\$ 1,893,025</u>

The accompanying notes are integral part of the financial statements

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

STATEMENTS OF CASH FLOWS
 YEARS ENDED JUNE 30, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
		<i>As Restated</i>
OPERATING ACTIVITIES:		
Cash received from customers and users	\$ 24,256,985	\$ 29,915,259
Cash payments to suppliers for goods and services	(18,287,009)	(17,246,219)
Cash payments to employees for services	(53,692,947)	(46,927,672)
Net cash used in operating activities	<u>(47,722,971)</u>	<u>(34,258,632)</u>
NON-CAPITAL FINANCING ACTIVITIES:		
Operating grants received from:		
Federal Transit Administration	19,203,315	12,135,420
Commonwealth of Puerto Rico	32,533,977	34,728,085
Interest paid	(4,148,737)	(4,581,351)
Payment of notes payable	(1,720,008)	(1,720,008)
Net cash provided by non-capital financing activities	<u>45,868,547</u>	<u>40,562,146</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Acquisition of capital assets	(3,867,038)	(13,019,221)
Capital contributions	2,500,000	10,225,283
Net cash used by capital and related financing activities	<u>(1,367,038)</u>	<u>(2,793,938)</u>
INVESTING ACTIVITIES:		
Interest received	<u>26,858</u>	<u>48,335</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(3,194,604)	3,557,911
CASH AND CASH EQUIVALENTS, at beginning of year	4,364,286	<u>806,375</u>
CASH AND CASH EQUIVALENTS, at end of year	<u>\$ 1,169,682</u>	<u>\$ 4,364,286</u>

The accompanying notes are integral part of the financial statements

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

STATEMENTS OF CASH FLOWS
 YEARS ENDED JUNE 30, 2009 AND 2008

	<u>2009</u>	<u>2008</u>
		<i>As Restated</i>
RECONCILIATION OF OPERATING LOSS TO NET CASH USED IN OPERATING ACTIVITIES:		
Operating loss	\$ (61,139,502)	\$ (53,817,445)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization	9,675,690	8,118,120
Loss on disposition of capital assets	1,360,852	-
Changes in operating assets and liabilities:		
Accounts receivable	(146,059)	(676,488)
Inventory	241,744	234,686
Prepaid expenses	266,498	-
Other assets	815	(815)
Accounts payable	(2,866,790)	9,934,267
Accrued expenses payable	4,883,781	1,949,043
Net cash used in operating activities	<u>\$ (47,722,971)</u>	<u>\$ (34,258,632)</u>

The accompanying notes are integral part of the financial statements

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

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED JUNE 30, 2009 AND 2008

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

The accounting policies of the Authority conform to accounting principles generally accepted in the United States of America as applicable to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standards setting body for establishing governmental accounting and financial reporting principles. The following is a summary of the significant accounting policies:

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

Use of Estimates

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

Cash and Cash Equivalents

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

Allowance for Doubtful Accounts

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

Inventories

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

Capital Assets

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

The estimated useful lives of the capital assets follow:

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

The Authority periodically reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. During the year ended June 30, 2009 the Authority retired from operations transportation equipment which reached the end of its useful life. A loss of approximately \$1,360,000 was recorded as result of such retirement.

Vacation and Sick Leave

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

Net assets

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

Invested in Capital Assets, Net of Related Debt

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

Unrestricted

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

Operating Revenues and Expenses

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

Contributions

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

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

Reclassifications

Certain reclassifications have been made to the 2008 figures to conform to current year's presentation.

Risk Financing

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

Accrual for legal claims

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

2. CASH AND CASH EQUIVALENTS

Cash and cash equivalents at June 30, 2009 and 2008 consist of cash on hand and on bank deposit accounts.

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

Pursuant to the Investment Guidelines for the Commonwealth adopted by Government Development Bank for Puerto Rico ("GDB"), the Authority may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, repurchase agreements, bankers acceptances, or in pools of obligations of the municipalities of Puerto Rico, among others. There are no investments at June 30, 2009 and 2008.

For deposits, custodial credit risk is the risk that in the event of bank failure, the Authority's deposits may not be returned to it. Under Puerto Rico statutes public funds deposited in commercial bank must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth of Puerto Rico. The bank balance of the Authority's deposit at June 30, 2009 and 2008, excluding deposits in Government Development Bank for Puerto Rico described below, amounted to approximately \$1,393,000 and \$3,548,000, respectively, of which \$773,000 and \$300,000 are insured by Federal Deposit Insurance Corporation at June 30, 2009 and 2008 respectively.

In addition, at June 30, 2009 and 2008, the Authority maintained cash deposited at the Governmental Development Bank for Puerto Rico (GDB), in the amount approximately \$71,000 and \$810,000, respectively. These amounts are uncollateralized since by law, the governmental banks of the Commonwealth of Puerto Rico are exempt of the requirement of insuring the deposits of funds of the entities of the Commonwealth of Puerto Rico.

3. ACCOUNTS RECEIVABLE

Accounts receivable at June 30, 2009 and 2008 consist of:

	<u>2009</u>	<u>2008</u>
Operating and capital grants:		
Federal government	\$ 1,590,043	\$ 4,627,406
Commonwealth of Puerto Rico	197,105	4,676,570
Puerto Rico Highways and Transportation Authority	1,572,556	1,572,556
Other	439,754	<u>1,223,402</u>
Total	3,799,458	12,099,934
Less allowance for doubtful accounts	383,022	<u>1,312,729</u>
Total	<u>\$ 3,416,436</u>	<u>\$ 10,787,205</u>

4. INVENTORY

Inventory at June 30, 2009 and 2008 consists of:

	<u>2009</u>	<u>2008</u>
Spare parts	\$ 3,361,672	\$ 3,561,767
Diesel and gasoline	187,348	204,772
Supplies	122,830	147,055
Total	<u>\$ 3,671,850</u>	<u>\$ 3,913,594</u>

5. TRANSACTIONS WITH RELATED ENTITIES

The Authority had an agreement with the Puerto Rico Highways and Transportation Authority (PRHTA) in which PRHTA agreed to pay the Authority an annual amount of \$23,200,000 for certain transportation services to be provided by the Authority. During the year ended June 30, 2009 such agreement was terminated. Therefore the amount received by the Authority during the year ended June 30, 2009 amounted to \$13,654,545.

6. CAPITAL ASSETS

The following schedule summarizes the capital assets held by the Authority as of June 30, 2009 and 2008:

	<u>Balance at June 30, 2008</u> <i>Restated</i>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2009</u>
Assets not being depreciated:				
Land and improvements	\$ 2,569,210	\$ -	\$ -	\$ 2,569,210
Assets being depreciated:				
Buildings and improvements	17,869,096			17,869,096
Terminals	4,100,692			4,100,692
Transportation equipment	96,404,604	-	(19,739,036)	76,665,568
Machinery and equipment	34,178,753	3,867,043	(197,848)	37,847,948
Total	152,553,145	3,867,043	(19,936,884)	136,483,304
Less accumulated depreciation	<u>96,433,678</u>	<u>9,675,695</u>	<u>(18,576,032)</u>	<u>87,533,341</u>
Capital assets being depreciated, net	<u>56,119,467</u>	<u>(5,808,652)</u>	<u>(1,360,852)</u>	<u>48,949,963</u>
Total capital assets, net	\$ 58,688,677	\$ (5,808,652)	\$ (1,360,852)	\$ 51,519,173

	<u>Balance at June 30, 2007</u> <i>Restated</i>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2008</u> <i>Restated</i>
Assets not being depreciated:				
Land and improvements	\$ 2,569,210	\$ -	\$ -	\$ 2,569,210
Assets being depreciated:				
Buildings and improvements	17,869,096			17,869,096
Terminals	4,100,692			4,100,692
Transportation equipment	86,349,866	12,781,604	(2,726,866)	96,404,604
Machinery and equipment	33,979,151	237,617	(38,015)	34,178,753
Total	142,298,805	13,019,221	(2,764,881)	152,553,145
Less accumulated depreciation	<u>91,243,462</u>	<u>7,955,097</u>	<u>(2,764,881)</u>	<u>96,433,678</u>
Capital assets being depreciated, net	<u>51,055,343</u>	<u>5,064,124</u>	<u>-</u>	<u>56,119,467</u>
Total capital assets, net	\$ 53,624,553	\$ 5,064,124	\$ -	\$ 58,688,677

7. BORROWINGS UNDER LINE OF CREDIT

The Authority has an unsecured line of credit with a commercial bank in which the Authority may borrow up to \$3,000,000. Borrowings under this of line of credit are by the assignment of diesel tax revenues and bear interest at LIBOR plus a spread as defined in the agreement (1.57% and 4% at June 30, 2009 and 2008, respectively).

A summary of the activity in the line of credit during the years ended June 30, 2009 and 2008 follows:

	<u>Balance at 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2009</u>	<u>Current Portion</u>
Borrowings under line of credit	\$ 3,000,000	\$ -	\$ -	\$ 3,000,000	\$ 3,000,000

	<u>Balance at 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2008</u>	<u>Current Portion</u>
Borrowings under line of credit	\$ 3,000,000	\$ -	\$ -	\$ 3,000,000	\$ 3,000,000

8. LONG-TERM DEBT

Long-term debt at June 30, 2009 and 2008 consist of:

	<u>Balance at 2008</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2009</u>	<u>Current Portion</u>
Secured note payable to bank	\$ 40,849,990	\$ -	\$ (1,720,008)	\$ 39,129,982	\$ 1,720,008

	<u>Balance at 2007</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at 2008</u>	<u>Current Portion</u>
Secured note payable to bank	\$ 22,303,832	\$ 43,000,000	\$ (24,453,842)	\$ 40,849,990	\$ 1,720,008

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

Estimated maturities of this note payable during the next years are as follows:

Year ending	
June 30,	
2010	\$ 1,720,000
2011	1,720,000
2012	<u>35,689,982</u>
Total	<u>\$ 39,129,982</u>

9. RETIREMENT PLAN

Substantially all the Authority's employees participate in the Retirement System of the Commonwealth of Puerto Rico ("the System"), a cost sharing multi-employer defined benefit pension plan. The payroll for employees covered by the System for the years ended June 30, 2009 and 2008 was approximately \$30 million and \$36 million, respectively.

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

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

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

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

Total employer contributions during the years ended June 30, 2009 and 2008 under this plan amounted to approximately \$2,772,000 and \$2,249,000 respectively.

Additional information on the Retirement System is provided in its financial statements for the year ended June 30, 2009 and 2008, a copy of which can be obtained from the Retirement System Administration, Minillas Station, P.O. Box 42003, San Juan, PR 00940.

10. COMMITMENTS AND CONTINGENT LIABILITIES

Litigation

The Authority is involved in litigation arising in the normal course of operations. Management believes that its ultimate liability, if any, in connection with these matters will not have a material effect on the Authority's financial condition and results of operations. Due to uncertainties in the settlement process, it is at least reasonably possible that management's view of the outcome of these claims will change in the near term. However, based on advice of legal counsel, management has recorded an estimated litigation and claim loss of approximately \$4,490,000 and \$2,235,000 as of June 30, 2009 and 2008, respectively.

Federal Assistance Programs

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

11. OPERATING FINANCIAL ASSISTANCE FROM THE COMMONWEALTH OF PUERTO RICO

As shown in the accompanying financial statements, the Authority has incurred in accumulated losses after operating and capital contributions in the amount of \$72 million and as of June 30, 2009 the Authority's liabilities exceeded its assets by approximately \$20 million. In addition, at June 30, 2009 the Authority has a working capital deficiency of approximately \$34 million making it difficult for the Authority to pay its liabilities in the normal course of business. These facts indicate that the Authority needs the continued support from the Commonwealth of Puerto Rico in the form of operating grants to continue to operate at its present level. Although the Commonwealth of Puerto Rico has experienced budget constraints during the current and prior years which have resulted in reductions in the operating grants provided to the Authority, management believes that with cost control programs, adherence to approved budget the Authority will be able to provide the transportation services with the assigned operating grant. Also management believes that since the transportation service provided by the Authority is an essential service to the people of Puerto Rico, the Commonwealth of Puerto Rico will continue to fund the operational deficits incurred by the Authority. Any significant reduction in these operating grants and financial support will affect the ability of the Authority to provide the transportation services and to continue as a going concern.

12. ADJUSTEMENT TO PRIOR YEARS ISSUED FINANCIAL STATEMENTS

During the year ended June 30, 2009, the Authority evaluated its accounting records and found that cost of transportation equipment and its related accumulated depreciation were not properly reflected in prior years issued financial statements. The effect of this adjustment was to increase the deficiency in net assets as of July 1, 2007 by approximately \$5,252,000 and to reduce the depreciation expense during the year ended June 30, 2008 by approximately \$466,000 and a related decrease in the net book value of transportation equipment at June 30, 2008 of \$4,786,000.