**COMMONWEALTH OF PUERTO RICO**

**PUERTO RICO ENERGY COMMISSION**

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| IN RE: REVIEW OF RATES OF THE PUERTO RICO ELECTRIC POWER AUTHORITY | NO. CEPR-AP-2015-0001<br><br>**SUBJECT: PREPA'S SUBMISSION OF INFORMATION REQUIRED BY SECTION 3.02 (D), (E) OF REGULATION 8720** |

**<u>REGULATION 8720 SECTION 3.02(E)</u>**

Copy of the most recent audited financial statements
and an independent auditor's opinion on such financial statements

# Financial Statements, Required Supplementary Information and Supplemental Schedules

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Years Ended June 30, 2014 and 2013
With Report of Independent Auditors

# Puerto Rico Electric Power Authority

(A Component Unit of the Commonwealth of Puerto Rico)

## Financial Statements, Required Supplementary Information and Supplemental Schedules

Years Ended June 30, 2014 and 2013

## Contents

# Financial Section

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# Report of Independent Auditors

To the Governing Board of the
Puerto Rico Electric Power Authority

## Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Electric Power Authority (the "Authority" or "PREPA"), a component unit of the Commonwealth of Puerto Rico as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the basic financial statements listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of PREPA Holdings LLC (a blended component unit), which financial statements reflect total assets constituting approximately .64% and .46% of total assets as of June 30, 2014 and 2013, and revenues constituting .65% of total revenues for the years then ended. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for PREPA Holdings, is based solely on the reports of the other auditors. We conducted our audits in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Opinion***

In our opinion, based on our audits and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Electric Power Authority as of June 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

***The Authority's Ability to Continue as a Going Concern***

The accompanying financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 19 to the financial statements, the Authority does not have sufficient funds available to fully repay its various obligations as they come due and has entered a process to restructure its long-term debt. The financial difficulties experienced by the Authority, including the uncertainty as to its ability to fully satisfy its obligations, raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Notes 19 and 20. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

***Adoption of GASB Statement No. 65, Items Previously Reported as Assets and Liabilities***

As discussed in Notes 2 and 18 to the financial statements, the Authority changed its method for accounting for bond issue costs and deferred losses related to bond refunding as a result of the adoption of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for periods beginning after July 1, 2012. Our opinion is not modified with respect to this matter.

***Required Supplementary Information***

U.S. generally accepted accounting principles require that management's discussion and the supplementary schedule of funding progress on pages 4 through 26 and 128, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Supplementary Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Puerto Rico Electric Power Authority's basic financial statements. The supplemental schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements.

The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements as a whole.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report, dated January 28, 2016, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Ernst + Young LLP

January 28, 2016

Stamp No. E201502
affixed to
original of
this report.

This section of the financial report of the Puerto Rico Electric Power Authority (the Authority) presents the analysis of the Authority's financial performance during the fiscal years ended June 30, 2014, 2013 and 2012. As management of the Authority, we offer readers of the financial statements this narrative overview and analysis of the financial activities. We recommend readers to consider the information herein presented in conjunction with the financial statements that follow this section.

**Financial Highlights**

- Operating income for fiscal year ended June 30, 2014 was **$223.0** million representing a decrease of **37.0 percent** from the fiscal year ended June 30, 2013. For the fiscal year ended June 30, 2013 operating income was $354.0 million representing an increase of 37.7 percent from the fiscal year ended June 30, 2012. For the fiscal year ended June 30, 2012 operating income was $257.0 million representing a decrease of 21.4 percent from the fiscal year ended June 30, 2011.

- Operating expenses decreased by $243.1 million or 5.4 percent for the fiscal year ended June 30, 2014; decreased by $300.5 million or 6.3 percent for the fiscal year ended June 30, 2013, and increased by $693.4 million or 16.9 percent for the fiscal year ended June 30, 2012.

- The Authority's Net Utility Plant for the fiscal year ended June 30, 2014 increased by **$8.9** million or **0.1 percent**. For the fiscal year ended June 30, 2013 net utility plant increased by $39.4 million or 0.6 percent. For the fiscal year ended June 30, 2012 the net utility plant decreased by $13.4 million or 0.2 percent.

- Total assets and deferred outflows increased by **$285.4 million**, decreased by **$108.0** million and increased by **$323.0** million, or **2.8 percent** increase, 1.0 percent decrease and 3.3 percent increase, respectively, for the fiscal years ended June 30, 2014, 2013 and 2012.

- For the fiscal year ended June 30, 2014, as compared to the fiscal year ended June 30, 2013 and fiscal year ended June 30, 2012, accounts receivable net increased by **7.2 percent** from **$1,511.9 million** to **$1,620.6 million**, increased by 10.8 percent from $1,364.6 million to $1,511.9 million, and increased by 6.8 percent from $1,277.9 million to $1,364.6 million, respectively. The increases in fiscal year 2014 and 2013 were mainly due to government sector accounts.

**Financial Highlights (continued)**

- Accounts receivable from the governmental sector increased **30.1 percent** from $617.6 million on June 30, 2013 to **$803.7 million** on June 30, 2014, and increased 43.9 percent from $429.3 million on June 30, 2012 to $617.6 million on June 30, 2013, and decreased 75 percent from $464.1 million on June 30, 2011 to $429.3 million on June 30, 2012.

- The Authority's net position decreased by **$419.9 million (49.6 percent)** and $272.1 million (47.3 percent) and $344.7 million (149.6 percent) as a result of operations during fiscal years ended June 30, 2014, 2013 and 2012, respectively. The Authority has been in a net deficit position since June 30, 2011.

- Ratios of fuel and purchased power adjustment revenues to total operating revenues were **78.9 percent**, 76.5 percent and 78.3 percent for years ended June 30, 2014, 2013 and 2012, respectively.

  Ratios of fuel oil and purchased power expense to total operating expense (excluding depreciation expense) were **80.3 percent**, 81.1 percent and 82.0 percent for fiscal years ended June 30, 2014, 2013 and 2012, respectively.

- The decrease in the fuel adjustment revenues and fuel expense for fiscal year 2014 as compared to 2013 of **$228.7 million** and **$258.6 million**, respectively, was mainly due to a decrease in the average fuel oil price per barrel of $4.46 (4.2%) and a decrease of 1.4 million barrels of fuel consumption. The decrease in the fuel adjustment revenues and fuel expense for fiscal year 2013 as compared to 2012 of $323.1 million and $298.2 million, respectively, was mainly due to a decrease in the average fuel oil price per barrel of $7.22 (6.1%). The increase in the fuel adjustment revenues and fuel expense for fiscal year 2012 as compared to 2011 of $606.2 million and $610.5 million, respectively, was mainly due to an increase in the average fuel oil price per barrel of $22.48 (23.4%).

**Financial Highlights (continued)**

- The increase in the purchased power adjustment revenue and expense of **$58.7 million** and **$51.9 million**, respectively, was due to an increase of price per kWh of purchased power by 1 cent (or 9.1%) for fiscal year 2014 when compared to fiscal year 2013. The increase in the purchased power adjustment revenue and expense of $78.8 million and $71.5 million, respectively, was due to an increase of 593,183 MWh (or 8.9 percent) in amount of purchase power for fiscal year 2013 when compared to fiscal year 2012. The increase in the purchased power adjustment revenue and expense of $26.3 million and $23.3 million, respectively, was due to an increase in the average cost per kWh of (10.6%) purchase power from 9 cents for fiscal 2011 to 10 cents for fiscal 2012.

**Financial Condition and Liquidity**

The Authority does not currently have sufficient funds available to fully repay its various obligations as they come due, and is working on extending the due date of the obligations and obtaining other concessions from its creditors, including pursuant to an exchange offer that would reduce the principal amount of some of its debts, obtaining more favorable covenants and other terms under its Trust Agreement via a consent solicitation, and obtaining new financing to provide relief and/or funds to repay the existing amounts of principal and interest or bring the outstanding balances current at the various due dates as well as to continue to operate and to finance capital improvement projects. The Commonwealth and its instrumentalities are also experiencing significant financial difficulties and may be unable to continue to repay amounts due to the Authority or to extend, refinance or otherwise provide the necessary liquidity to the Authority as and when needed. The Authority has receivables of over $803.7 million payable by the Commonwealth and related entities and is subject to significant uncertainty with regard to its ability to collect on such receivables. As a consequence, the Authority may not be able to avoid future defaults on its obligations. Management has plans to address the Authority’s liquidity situation and continue providing services and believes the Authority will be able to repay or refinance its obligations, as described in Note 19 and Note 20. However, there can be no assurance that the affiliated or unaffiliated creditors will be able and willing to refinance or modify the terms of the Authority’s obligations, that management’s current plans to repay or refinance the obligations or extend their terms will be achieved or that certain services will not have to be terminated, curtailed or modified.

## Plans to Address the Authority's Challenges

The Authority faces a number of business challenges that have been exacerbated by the Commonwealth's economic recession and financial difficulties. Its principal challenges, some of which are interrelated, include: (i) addressing its relatively high cost of the type of fuel it uses compared to other energy sources and aging generation fleet; (ii) compliance with applicable environmental regulations; (iii) declining electric energy sales; (iv) addressing government accounts receivables; (v) improving liquidity; and (vi) taking steps to ensure the Authority's long-term fiscal sustainability, including its ability to satisfy its financial obligations.

In July 2014, the Authority began discussions with its financial stakeholders in an effort to stabilize the Authority's liquidity situation and address its financial position. The Authority subsequently engaged legal, financial and operational advisors, including a chief restructuring officer, to assist it in those efforts. In the period since July 2014, the Authority has entered into various agreements with certain of its financial stakeholders as discussed below.

*Forbearance Agreements*

On August 14, 2014, the Authority entered into forbearance agreements (the "Forbearance Agreements") with certain insurers of the Authority's Power Revenue Bonds ("Bonds") and beneficial owners of the Bonds controlling, collectively, more than 60% of the principal amount of the Bonds then outstanding (comprising the Ad Hoc Group (as defined below)) and the monoline insurers providing credit support for certain of the Authority's Bonds not owned by the Ad Hoc Group (the "monoline bond insurers" and together with the Ad Hoc Group, the "Forbearing Bondholders"), banks that provide revolving lines of credit used to pay for purchased power, fuel and other expenses (together, with their transferees, as applicable, the "Forbearing Lenders") and Government Development Bank for Puerto Rico ("GDB," and together with the Forbearing Bondholders and the Forbearing Lenders, the "Forbearing Creditors").

Under the Forbearance Agreements, the Forbearing Creditors agreed to forbear from the exercise of certain rights and remedies under their applicable debt instruments. The Forbearance Agreements were originally scheduled to terminate on March 31, 2015, but were extended by certain of the Forbearing Creditors on numerous occasions, most recently through November 5, 2015. The Forbearance Agreements expired on November 5, 2015, but the agreement of the Forbearing Creditors to refrain from exercising of certain rights and remedies was extended under the RSA (as defined below).

*Forbearance Agreements (continued)*

Under the Forbearance Agreements with the Forbearing Bondholders, the Authority's obligations to pay any and all principal and interest payments on the Bonds were required to continue; however, the Forbearing Bondholders agreed that the Authority was not required to make transfers to the Revenue Fund or the Sinking Fund pursuant to sections 506 and 507 of the Trust Agreement while that agreement remained in effect. The Authority has not made monthly cash deposits into the Sinking Fund since July 2014. This agreement was extended and continued under the RSA. Since entry into the Forbearance Agreements, the Authority has paid all principal and interest payments due on the Bonds.

Under the Forbearance Agreements with the Forbearing Lenders, the Authority was permitted until November 5, 2015 to delay certain payments that became due to the Forbearing Lenders in July and August 2014. Under the RSA, the Authority was permitted to delay such payments further until June 30, 2016; however, the Authority has continued to pay interest to the Forbearing Lenders while those agreements remain in effect.

In connection with the Forbearance Agreements and in order to address the Authority's liquidity challenges, on August 27, 2014, the Trust Agreement was amended to permit the Authority to use approximately $280 million held in its construction fund for payment of current expenses in addition to capital improvements. The amendment also provided for an increase in the thresholds required for the exercise of remedies under the Trust Agreement. Those amendments expired on March 31, 2015.

In connection with an extension of the Forbearance Agreements executed on June 30, 2015 and the Authority's agreement to pay approximately $415.8 million of principal and interest due on July 1, 2015 on the Bonds, the Trust Agreement was again amended to increase the thresholds for the exercise of remedies under the Trust Agreement and to allow for the issuance of $130.7 million in Bonds to the monoline bond insurers (the "2015A Bonds") that matured on January 1, 2016. Those amendments expired on September 1, 2015. On December 15, 2015, the Authority defeased the outstanding principal and interest requirements on the 2015A Bonds, and the 2015A Bonds were paid in full on the first business day of January 2016 (January 4, 2016) in accordance with their terms.

*Bond Payments*

On July 1, 2014, the Authority paid $413.7 million to satisfy the principal and interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves.

On January 2, 2015, the Authority paid $204.4 million to satisfy the interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves.

On July 1, 2015, the Authority paid $415.8 million, to satisfy the principal and interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves, and a $153.0 million transfer from the General Fund.

On July 31, 2015, pursuant to the Trust Agreement and as agreed with Forbearing Creditors, the Authority issued Power Revenue Bonds Series 2015A, in a par amount of $130.7 million (the Series 2015 A Bonds), to replenish the Authority's working capital. The Series 2015 A Bonds were bought in their entirety by the monoline bond insurers, and the maturity date of this issue was January 1, 2016. The Authority paid $6.1 million, $5.9 million, $5.8 million, $5.8 million and $6.4 million for the first five months that ended on November 1, 2015 to redeem a portion of the Series 2015 A Bonds.

On December 15, 2015, the Authority deposited $103.5 million in escrow to satisfy the remaining principal and interest requirements on the Series 2015 A Bonds, which deposit was funded by $100.9 million from Self-insurance Fund and $2.6 million from General Fund. These amounts were paid to holders of the 2015 A Bonds on January 4, 2016 in accordance with their terms.

On January 4, 2016, the Authority paid $198.0 million, to satisfy the interest payments on its other Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, and a $171.0 million transfer from the General Fund.

*Agreements with Certain Forbearing Creditors*

Agreement in Principle with Ad Hoc Group

On September 2, 2015, PREPA announced an agreement in principle regarding the economic terms of a restructuring with an ad hoc group of bondholders that were Forbearing Bondholders (the “Ad Hoc Group Agreement”) and which group held, at that time, approximately 35% in principal amount of the outstanding Bonds (the “Ad Hoc Group”).

Under that agreement, the Ad Hoc Group will have the option to receive securitization bonds that will pay cash interest at a per annum rate of 4.0% - 4.75% (depending on the rating obtained) (“Option A Bonds”) or convertible capital appreciation securitization bonds that will accrete interest at a per annum rate of 4.5% - 5.5% for the first five years and pay current interest in cash thereafter at those per annum rates (“Option B Bonds”). Option A Bonds will not pay principal for the first five years (interest only), and Option B Bonds will accrete interest but not receive any cash interest or principal during the first five years. All of PREPA’s uninsured bondholders will have an opportunity to participate in the exchange. Both Option A and Option B Bonds would be issued at an exchange ratio of 85% (i.e., with a 15% reduction in principal amount of current holdings of outstanding Bonds).

Under the extension to the Forbearance Agreement with the Ad Hoc Group executed on September 1, 2015, PREPA agreed to work collaboratively and in good faith with the Ad Hoc Group to reach agreement on a recovery plan incorporating these terms. The Ad Hoc Group Agreement was included in the RSA.

Agreement in Principle with Forbearing Lenders of Notes Payables

On September 22, 2015, PREPA announced an agreement in principle regarding economic terms with its Forbearing Lenders (the “Fuel Line Agreement”).

Under that Agreement, the Forbearing Lenders, which hold all of the approximately $696 million of matured debt (Notes Payable), will have the option to either (1) convert their existing credit agreements into term loans, with a fixed interest rate of 5.75% per annum, to be repaid over six years in accordance with an agreed amortization schedule or (2) exchange all or part of principal due under their existing credit agreements for new securitization bonds to be issued on the same terms as the Ad Hoc Group.

Agreement in Principle with Forbearing Lenders of Notes Payables (continued)

Under the extensions to the Forbearance Agreements with the Forbearing Lenders executed on September 22, 2015, PREPA agreed to work collaboratively and in good faith with the Forbearing Lenders to reach agreement on a recovery plan incorporating these terms. The Fuel Line Agreement was included in the RSA.

Terms and Status of Restructuring Support Agreement

On November 5, 2015, PREPA announced its entry into a restructuring support agreement (the “Initial RSA”) with both the Ad Hoc Group (representing at that time approximately 40% in principal amount of the outstanding Bonds) and the Forbearing Lenders setting forth the agreed-upon terms of PREPA’s recovery plan which terms were amended to extend the milestone dates therein on numerous occasions. The economic terms set forth in the Initial RSA are consistent with the Ad Hoc Group Agreement and the Fuel Line Agreement. In addition, pursuant to the Initial RSA, GDB would receive substantially the same treatment on $35.9 million owed by PREPA to it as the Forbearing Lenders will receive. The monoline bond insurers were not party to the Initial RSA.

On December 23, 2015, certain of the monoline bond insurers along with the Ad Hoc Group (representing together at that time approximately 66% in principal amount of the outstanding Bonds), the Forbearing Lenders and GDB, all signed an amended and restated restructuring support agreement (the “A&R RSA” and together with the Initial RSA and the Revised RSA (as defined below), the “RSA” and the Ad Hoc Group, the monoline bond insurers, the Forbearing Lenders and the GDB, together the “Supporting Creditors”) with terms and conditions substantially similar to those in the Initial RSA outlined above (including the agreement to exchange Bonds held by the Ad Hoc Group for new securitization bonds at an 85% exchange ratio with a 5-year principal holiday and fixed interest rates).

Significant uncertainty remains as to the potential consummation of the transactions set forth in the RSA, which is subject to a number of material conditions, including without limitation, (1) obtaining legislative authority for the assessment of a special, transition charge on the Authority’s customers and other terms to facilitate the issuance of the securitization bonds as well as organizational reforms at the Authority; (2) receipt of an investment grade rating on the new securitization bonds from any credit rating agency that will rate the securitization bonds; (3) obtaining an agreed upon level of participation from holders of the Authority’s uninsured Bonds in the exchange offer described above such that no more than $700 million in principal amount of uninsured Bonds shall remain outstanding following the exchange offer, or such higher

Terms and Status of Restructuring Support Agreement (continued)

amount determined by the Authority after consulting with the Authority's advisors; (4) amending the Trust Agreement to increase to at least a majority the percentage of Bondholders required to direct the Trustee to take certain actions under the Trust Agreement, including upon a default by the Authority and continue the waiver of the Authority's obligation to make monthly Sinking Fund deposits, among other things; and (5) obtaining approval and reaching agreement with all Supporting Creditors regarding the definitive documentation of the various restructuring transactions.

The RSA contains a number of termination or withdrawal events in favor of the Supporting Creditors, including if there is a material amendment to certain terms of the recovery plan, if the Authority commences any proceeding under bankruptcy or insolvency law or the Recovery Act (except to implement the recovery plan in accordance with the RSA), as well as the failure to achieve certain milestones by specific dates, including the enactment of legislation containing substantive provisions to implement the recovery plan contemplated by the RSA, among other events, which would result in termination of the RSA or withdrawal from the RSA by individual Supporting Creditors.

On January 23, 2016, the RSA terminated when the PREPA Revitalization Act was not enacted into law and the Ad Hoc Group did not agree to the Authority's request to extend the related RSA milestone. PREPA continued to engage in discussions with the Ad Hoc Group and the other Supporting Creditors regarding a potential extension of the RSA and the transactions contemplated therein and described below.

Under the RSA, certain of the Supporting Creditors had agreed to purchase approximately $115 million in Bonds to refund a portion of the interest payments on the Bonds made on January 4, 2016, subject to certain conditions including enactment of the PREPA Revitalization Act in acceptable form. This agreement was formalized in a Bond Purchase Agreement (the "Initial Bond Purchase Agreement") executed on December 29, 2015. The Initial Bond Purchase Agreement also terminated on January 23, 2016 when the A&R RSA terminated. PREPA continued to engage in discussions with the Supporting Creditors regarding the transactions contemplated by the Initial Bond Purchase Agreement.

On January 23, 2016, certain of the Forbearing Lenders agreed to enter into a short form forbearance agreement by which they agreed to forbear from exercising enforcement rights against the Authority under the applicable Fuel Line Agreements through February 12, 2016.

Terms and Status of Restructuring Support Agreement (continued)

On January 27, 2016, PREPA and the Supporting Creditors executed a revised RSA ("Revised RSA") and a revised Bond Purchase Agreement (the "Revised Bond Purchase Agreement"). The Revised RSA is substantially the same as the A&R RSA, with minor adjustments to address delays in legislative consideration of the PREPA Revitalization Act. The milestone date for legislative approval of the PREPA Revitalization Act was extended to February 16, 2016, and other related milestones were also adjusted accordingly. The Revised Bond Purchase Agreement is substantially the same as the Initial Bond Purchase Agreement, except for certain changes to the timing, conditions and total amount of the contemplated Bond purchase. Under the Revised Bond Purchase Agreement, 50% of the total purchased Bonds will be purchased upon a determination by the applicable Supporting Creditors that the PREPA Revitalization Act satisfies the standards set forth in the RSA and 50% of the total purchased Bonds will be purchased upon the filing of a petition with the Energy Commission seeking approval of a securitization charge that satisfies the standards under the RSA. Under the Revised Bond Purchase Agreement, the total amount of purchased Bonds is approximately $111 million. There can be no assurance, however, that the transactions contemplated by the Revised Bond Purchase Agreement will be consummated.

Under the RSA, the Ad Hoc Group has agreed to exchange 100% of its uninsured Bonds for securitization bonds at an 85% exchange ratio. The monoline bond insurers agreed to provide up to $462 million of reserve surety bonds at the time the transaction closes and forward commitments for additional surety capacity to be provided at a later time during the term of the transaction, as credit support for the securitization bonds, that would be available to be drawn upon in the event certain cash reserves and transition payments from PREPA's customers are insufficient to pay current debt service on the securitization bonds. In return for this, (1) the SPV (defined below – see PREPA Revitalization Act) would issue $2.086 billion additional securitization bonds, which amount is subject to adjustment in accordance with the RSA, as credit support for outstanding Authority's insured Bonds to be held in escrow for the benefit of holders of the Authority's insured Bonds and (2) PREPA and the SPV would attempt to refinance certain outstanding Bonds insured by such insurers with securitization bonds during a 6-month period starting 3 years after the date the above exchange closes. The surety bonds provided by the monoline bond insurers would be replaced by SPV cash (derived from transition payments) beginning in FY2019 over a period of nine years, subject to earlier replacement in accordance with certain conditions set forth in the RSA. Among the primary purposes for this transaction are to refinance at a lower cost a portion of the Authority's outstanding Bonds and to improve the Authority's liquidity position during the first five years after issuance. There can be no assurance, however, that the transactions contemplated by the RSA will be consummated.

Terms and Status of Restructuring Support Agreement (continued)

It should be noted that Bondholders holding beneficially approximately $2.73 billion in principal amount of outstanding Bonds representing approximately 34% in principal amount of the outstanding Bonds, have not agreed to the terms of the RSA, and without access to a statutory restructuring regime the terms of their Bonds also cannot be amended until an agreement with such Bondholders has been reached. As discussed below, the Authority is currently not in compliance with certain terms of its Trust Agreement and such Bondholders, who are not covered by the agreements described above, could direct the trustee to take certain actions, or otherwise exercise enforcement actions, against the Authority, each in accordance with the Trust Agreement, which actions could result in a default being declared.

*Trust Agreement Covenants*

As a result of the Authority's non-compliance with certain covenants existing under the Trust Agreement, Bondholders not covered by the agreements described above could direct the trustee to take certain actions, or otherwise exercise enforcement actions, against the Authority, including declaring an event of default as a result of covenant violations, each in accordance with the terms of the Trust Agreement.

Under the Trust Agreement, upon a covenant violation, no remedies may be exercised by the trustee on behalf the Bondholders until the trustee notifies the Authority of the particular violation and the Authority does not cure the violation within 30 days after receipt of such notice. The Authority has not received any such notice from the trustee.

*PREPA Revitalization Act*

On November 4, 2015, the Governor submitted the PREPA Revitalization Act to the Legislative Assembly to facilitate the Authority's ongoing transformation and recovery plan. The PREPA Revitalization Act sets forth a framework for PREPA to execute on the agreements with creditors reached to date. Among other things, the PREPA Revitalization Act would (1) enhance PREPA's governance processes; (2) adjust PREPA's practices for hiring and managing management personnel; (3) change PREPA's processes for collecting outstanding bills from public and private entities; (4) improve the transparency of PREPA's billing practices; (5) implement a competitive bidding process for soliciting third party investment in PREPA's infrastructure; (6) authorize the refinancing of outstanding Bonds through a securitization that would reduce PREPA's indebtedness and cost of borrowing; and (7) set forth an expedited process for the Energy Commission to approve or reject PREPA's proposal for a new rate structure that is consistent

*PREPA Revitalization Act (continued)*

with its recovery plan. The Legislative Assembly is currently considering various amendments to the PREPA Revitalization Act. There can be no assurance, however, that the PREPA Revitalization Act will be enacted into law or that it will contain provisions that are acceptable to the Authority's various creditors.

As described above, if enacted the PREPA Revitalization Act would provide a legal framework to reduce the Authority's cost of borrowing and its passage in the form contemplated by the RSA is one of the conditions to the execution of the restructuring transactions contemplated by the RSA and described above. The legislation would authorize creation of a bankruptcy-remote, special purpose public corporation (the "SPV"), entirely separate from the Authority, with the power to issue securitization bonds for limited purposes related to the Authority's recovery plan, and to impose non-by passable, transition charges on the Authority's customers. The assessment and periodic automatic adjustments of the transition changes on the Authority's customers would serve as the source of repayment for the securitization bonds.

*U.S. Congress Consideration of Bankruptcy Amendment*

Commonwealth officials have been urging the U.S. Congress to amend the federal bankruptcy code to eliminate an exclusion that currently bars any municipality or other instrumentality of the Puerto Rico government from restructuring under the federal bankruptcy code. U.S. legislative discussions on this are expected to continue in January 2016 and beyond.

*Operational Improvements*

The Authority has also made significant investments in evaluating and implementing various operational improvements and strategies in an effort to address its ongoing financial challenges.

In an effort to diversify its fuel supply, the Authority has entered into agreements necessary for the construction of an offshore gas port terminal to receive natural gas off the southern part of the island for use in the Aguirre Power Complex. The permitting process for the project is ongoing, and construction has not yet begun. Once operational, the gas port will provide a method to utilize liquefied natural gas at Aguirre.

The Authority reduced its number of employees through a combination of attrition from voluntary retirement and the elimination of temporary and vacant positions. In addition, the Authority continues to enforce the new employee hiring freeze implemented in January 2009.

*Operational Improvements (continued)*

On September 4, 2014, the Authority appointed a chief restructuring officer whose mandate includes providing overall leadership to the Authority's restructuring process, developing a business plan, implementing revenue improvement and cost reduction plans, overseeing and implementing cash and liquidity management activities, improving the Authority's ability to analyze, track and collect accounts receivable, improving the Authority's capital expenditure plan, and developing plans to improve the Authority's generation, transmission, distribution and other operations.

**Overview of Financial Report**

Management's Discussion and Analysis (MD&A) of operating results serves as an introduction to the basic financial statements and supplementary information. Summary financial statement data, key financial and operational indicators used in the Authority's strategic plan, projected capital improvement program, operational budget and other management tools were used for this analysis.

**Required Financial Statements**

The financial statements report the financial position and operations of Puerto Rico Electric Power Authority and its blended component units, Puerto Rico Irrigation Systems and PREPA Holdings LLC as of and for the year ended June 30, 2014, which include a Statement of Net Position, Statement of Revenues, Expenses and Changes in Net Position, Statement of Cash Flows and the notes to financial statements.

PREPA Networks, LLC issued a separate financial report that includes audited financial statements. That report may be obtained by writing to PREPA Networks, Corp. City View Plaza Suite 803, Guaynabo, Puerto Rico 00968.

The Statement of Net Position presents the financial position of the Authority and provides information about the nature and amount of resources and obligations at year-end.

**Required Financial Statements (continued)**

The Statement of Revenues, Expenses and Changes in Net Position present the results of the business activities over the course of the fiscal year and information as to how the net assets changed during the fiscal year.

The Statement of Cash Flows shows changes in cash and cash equivalents, resulting from operating, non-capital and capital financing, and investing activities, which include cash receipts and cash disbursement information, without consideration of the depreciation of capital assets.

The notes to the financial statements provide information required and necessary to the understanding of material information of the Authority's financial statements. These notes present information about the Authority's significant accounting policies, significant account balances and activities, risk management, obligations, commitments and contingencies, and subsequent events.

The financial statements were prepared by the Authority's management from detailed accounting books and records.

**Financial Analysis**

The Authority's net position decreased by **$419.8** million, $272.1 million and $344.7 million for the fiscal years ended June 30, 2014, 2013 and 2012, respectively. Our analysis below focuses on the Authority's net position and changes in net position during the year.

**Financial Analysis (continued)**

**Authority's Net Position**
(*In thousands*)

| | Year Ended June 30 | | |
|---|---|---|---|
| | **2014** | **2013** *(as restated)* | **2012** *(as restated)* |
| Current, non-current and other assets | **$ 3,504,903** | $ 3,177,881 | $ 3,283,933 |
| Deferred outflows | **126,812** | 177,283 | 218,648 |
| Capital assets | **6,847,456** | 6,838,558 | 6,799,176 |
| Total assets and deferred outflows | **$ 10,479,171** | $ 10,193,722 | $ 10,301,757 |
| Long-term debt outstanding | **$ 9,413,195** | $ 8,987,971 | $ 9,042,843 |
| Other liabilities | **2,332,981** | 2,052,946 | 1,834,036 |
| Total liabilities | **$ 11,746,176** | $ 11,040,917 | $ 10,876,879 |
| Net position (deficit): | | | |
| Net investments in utility plant | **$ (253,448)** | $ (32,432) | $ (21,314) |
| Restricted | **–** | – | 18,299 |
| Unrestricted | **(1,013,557)** | (814,763) | (572,107) |
| Total net position (deficit) | **$ (1,267,005)** | $ (847,195) | $ (575,122) |

A portion of the Authority's net position reflects its net investment in utility plant, which decreased from $23.4 million to $3.6 million as of June 30, 2013 and 2014, respectively.

**Financial Analysis (continued)**

Changes in the Authority's net position can be determined by reviewing the following condensed Statements of Revenues, Expenses and Changes in Net Position.

**Authority's Changes in Net Position**
*(In thousands)*

| | Year Ended June 30 | | |
|---|---|---|---|
| | **2014** | 2013 *(as restated)* | 2012 *(as restated)* |
| Operating revenues | **$ 4,468,922** | $ 4,843,016 | $ 5,046,494 |
| Other income | **21,157** | 26,329 | 24,344 |
| Total revenues | **4,490,079** | 4,869,345 | 5,070,838 |
| Operating expenses | **4,245,892** | 4,488,979 | 4,789,469 |
| Interest expense, net | **431,180** | 386,867 | 380,424 |
| Total expenses | **4,677,072** | 4,875,846 | 5,169,893 |
| Loss before contribution in lieu of taxes and other and contributed capital | **(186,993)** | (6,501) | (99,055) |
| Contribution in lieu of taxes and other | **(277,776)** | (297,551) | (283,111) |
| Loss before contributed capital | **(464,769)** | (304,052) | (382,166) |
| Contributed capital | **44,959** | 31,979 | 37,494 |
| Change in net position | **(419,810)** | (272,073) | (344,672) |
| Net position at beginning of year | **(847,195)** | (575,122) | (230,450) |
| Net position at end of year | **$ (1,267,005)** | $ (847,195) | $ (575,122) |

**Financial Analysis (continued)**

For fiscal year ended June 30, 2014, as compared to June 30, 2013, net position decreased by $419.8 million, a $147.7 million decrease when compared to the decrease for fiscal year ended June 30, 2013. The reduction in net position was mainly due to a combination of factors that included, among others, a decrease in operating revenues of $374.1 million, mainly due to a decrease in energy sales per kWh from 18.2 million in 2013 to 17.6 million in 2014 (3.3%), representing a $16.8 million basic revenue decrease, and an increase in the reserve for uncollectible accounts of $191.5 million during the fiscal year 2014, due to a change in the assumptions related to collections, as a result of the recent economic situation facing Puerto Rico, net of a decrease in operating expenses of $243.1 million, mainly as a result of a decrease in fuel prices.

For fiscal year ended June 30, 2013, as compared to June 30, 2012, net position decreased by $272.1 million. The reduction in net position was mainly due to a combination of factors that included, among others, a decrease in operating revenues of $203.5 million and operating expenses of $300.5 million, resulting in a net decrease in operating income of $97.0 million. Decreases in fuel oil prices, a decrease in depreciation expense of $69.9 million due to the implementation of a new depreciation study, offset by increases in interest expense, and contributions in lieu of taxes contributed to the reduction in operating income. In addition, the Authority's net revenues were reduced by $53.2 million in fuel adjustment revenues not billed to customers, which reduction was financed by the revenue stabilization fund.

For fiscal year ended June 30, 2012, as compared to June 30, 2011, net position decreased by $344.7 million. The reduction in net position was mainly due to a combination of factors that included, among others, an increase in operating revenue of $623.5 million and operating expenses of $693.4 million, resulting in a net decrease in operating income of $69.9 million. Increases in fuel oil prices and an increase in depreciation expense of $63.9 million, as well as increases in interest expense, and contributions in lieu of taxes contributed to the reduction in operating income. In addition, the Authority's net revenues were reduced by $79.4 million in fuel adjustment revenues not billed to customers, which was financed by the revenue stabilization fund and $37.2 million of costs related to the abandoned Vía Verde Project (Natural Gas Pipeline Project), which were registered as operating expenses.

## Capital Assets and Debt Administration

*Net Investment in Utility Plant*

Net investment in utility plant in fiscal years as of June 30, 2014, 2013 and 2012, amounted to approximately **$6,847 million**, $6,839 million, and $6,799 million (net of accumulated depreciation), respectively. This net investment in utility plant includes land, generation, transmission and distribution systems, buildings, fixed equipment, furniture, fixtures and equipment. The Authority's net investment in utility plant increased by **0.1 percent**, increased by 0.6 percent and decreased by 0.2 percent for years ended June 30, 2014, 2013 and 2012, respectively.

A substantial portion of the capital expenditures for production plant in fiscal years ended June 30, 2014, 2013 and 2012, was spent on the rehabilitation and life extension of generating plants in order to maintain availability, reliability and efficiency.

Major capital assets projects undertaken by Authority during fiscal years 2014 and 2013 included the following:

- Conversion of units 5 and 6 at the Costa Sur Power Plant to dual fuel, representing approximately 820 MW of generating capacity. Improvements to boiler's internal components to burn 100% of natural gas have been completed for unit 6 as well as for unit 5. These capital improvement projects were completed during summer 2013.

- Regular scheduled comprehensive maintenance of its steam unit fleet, combined-cycle units and combustion turbine peaking units. Boilers and turbine-generators are included in this comprehensive maintenance program.

- Projects for the supply of water for industrial processes and generation. The new demineralized water plant at Costa Sur Power Plant, is an example of a key capital improvements focused on reliability and natural resources protection.

**Capital Assets and Debt Administration (continued)**

- Water infrastructure projects in order to comply with the current and future NPDES Discharge permits at San Juan Power Plant and Aguirre Power Complex. The integration of advanced water treatment technologies for reusing process wastewater will benefit the surrounding environment and reduce the process water - with the exception of the non-contact cooling water discharge – will be achieved with this project. In addition, the Aguirre Water Supply Project will substitute the underground water extraction from Southern Aquifer – which is currently experiencing salt infiltration – to superficial water supply from the Patillas Irrigation Channel and will supply a fresh water supply to a deteriorated black mangrove area in Jobos Bay for restoration. The expected date to complete the Aguirre Water Supply Project is July 2017. The San Juan Power Plant Project will reuse the process wastewater of two main outfalls. Phase I – reuse of the feed water heater condensations – the expected in service date is December 2015. Phase IV, which includes the integration of microfiltration and reverse Osmosis treatment technologies, is under a bid adjudication process. The San Juan Power Plant Project expected in service date is at end of 2017.

- New RO (Reverse Osmosis) and EDI (Electrode ionization) System installed at South Coast Power Plant is currently commissioned and will provide high reliability and water quality assurance to PREPA’s only natural gas burning power plant.

- The Authority is constructing a 230 kV transmission line (38 mile long) between the South Coast Steam Plant and Cambalache Gas Turbines Plant’s switchyard. The first stage of this project consists of the reconstruction and conversion to 230 kV of an existing 115 kV circuit line between the South Coast Steam Plant and Dos Bocas Hydroelectric Power Plant. The second stage of the project consists of the construction of a new 230 kV line from Dos Bocas to the Cambalache facilities. The expected service date is December 2015. The estimated cost of this project is $50 million. Once in operation, this major infrastructure project will significantly enhance the reliability and security margins of the transmission system, and permit the increase of power transfers from the South of Puerto Rico to the Northern and Western regions.

**Capital Assets and Debt Administration (continued)**

- Reconstruction and rehabilitation of 115 and 38 kV circuit lines throughout the whole island. It includes the reconstruction of a 42 miles of 115 kV transmission line interconnecting the Bayamon Transmission Center (TC), Cana 115 kV switchyard, Barrio Piñas 115 kV switchyard, Dos Bocas Hydroelectric Plant as well as important substations in the municipalities of Bayamon, Toa Baja, Toa Alta, Corozal, Morovis and Ciales. This project consists of seven phases. The first is the reconstruction of 3.7 miles of 115 kV transmission line with a 556.6 MCM conductor from Piñas Switchyard to the Monterrey Substation, completed in April 2014. The second is the reconstruction of 3.7 miles of 115 kV transmission line with a 556.6 MCM conductor from Monterrey Substation to the Unibon Substation, in service since October 2015. The third is the reconstruction of 4.7 miles of 115 kV transmission line with a 556.6 MCM conductor from Unibon Substation to the Morovis Substation, expected in service date is December 2017. The fourth is the reconstruction of 6.5 miles of 115 kV transmission line with a 1,119.5 MCM conductor from Bayamon TC to the Cana TC, expected in service date is February 2016. The Fifth is the reconstruction of 3 miles of 115 kV transmission line with a 1,119.5 MCM conductor from Cana TC to the Piñas Switchyard, expected in service date is October 2016. The Sixth is the reconstruction of 3.9 miles of 115 kV transmission line with a 556.6 MCM conductor from Morovis to the Ciales Substation, expected in service date is December 2017. The Seventh is the reconstruction of 17 miles of 115 kV transmission line with a 556.6 MCM conductor from Ciales Substation to the Dos Bocas Hydroelectric Plant, expected in service date is fiscal year 2024. The reconstruction and rehabilitation of four 115 kV transmission line interconnecting the Palo Seco power plant with relevant 115/38 kV transmission centers located in the metropolitan area are also included, expected in service date is the fiscal year 2022. Sub-transmission circuits interconnecting substations in the municipalities of Orocovis, Barranquitas, Maricao, Las Marías and Mayaguez, located in the central and west regions of the island, are part of this major reconstruction and rehabilitation plan.

**Capital Assets and Debt Administration (continued)**

- Program to improve the 38 kV sub-transmission systems continues, including the construction of underground 38 kV line in Medical Center of Puerto Rico, eliminating the tap on line 8900 and integrating a new circuit in Centro Medico Sectionalizer. This project consists of the interconnection of the 38 kV sectionalizer to the critical loads of University Hospital, Cardiovascular Center and the Medical Sciences hospitals, expected in service date is 2017. In addition, major reconstruction project of aerial 38 kV lines in the central and western part of the Island will significantly improve the reliability of the sub-transmission system. The 38 kV line required increasing the capacity to meet load on Barranquitas and provide the interconnection to Toro Negro Hydroelectric Plant, Comerío Transmission Center and the new transmission center in Barranquitas, expected in service date is the fiscal year 2016. In addition, the 38 kV 1500 and 2000 Line increase reliability by line improvement due to structural, line hardware deterioration, expected in service date is the fiscal year 2017.

- New air insulated 115/38 kV transmission center in the municipality of Barranquitas, which improves the reliability and efficiency of the System while increasing its power transfer capability and improving voltage regulation of the sub-transmission system under normal conditions and contingency situations was completed in June 2015.

- Construction of two additional insulated 115/38 kV switchyards in the municipalities of San Juan and Caguas expected to be completed in August 2016. The Buen Pastor Transmission Center will contribute to improve the reliability of the commercial and industrial loads in Río Piedras under certain contingency situations in the southern metropolitan area. The Bairoa Transmission Center will significantly improve the reliability at Caguas and nearby municipalities, by providing backup to 115/38 kV transformer contingencies located at the Caguas Transmission Center. Additional projects are planned to increase the power transfer capability from the 115 kV transmission systems to the subtransmission system by adding transformation capacity in existing switchyards such as San Juan Steam Plant, Bayamón TC and Monacillo TC.

- San Juan GIS 38 kV and 115 kV switchgears expected to enter into service in fiscal year 2017. This will be one of the Authority’s major gas insulated 115/38 kV switchyards with direct interconnection through the existing air insulated 115 kV bus to approximately more than 850 MW of generating capability.

**Capital Assets and Debt Administration (continued)**

These projects were funded from cash reserves, excess-operating revenues (when available), grants, and debt issued for such purposes.

***Long-Term Debt***

At the end of the fiscal years **2014**, 2013 and 2012, the Authority had total debt outstanding of **$9,413.2 million**, $8,987.9 million, and $8,935.5 million, respectively, comprised of revenue bonds and notes payable.

**Authority's Outstanding Debt**
*(In thousands)*

| | **2014** | **2013** | **2012** |
|---|---|---|---|
| Power revenue bonds, net | **$ 8,668,425** | $ 8,218,912 | $ 8,419,030 |
| Notes payable | **744,770** | 769,059 | 623,813 |
| | **9,413,195** | 8,987,971 | 9,042,843 |
| Current portion | **(1,166,189)** | (1,175,311) | (1,000,255) |
| Long-term debt, excluding current portion | **$ 8,247,006** | $ 7,812,660 | $ 8,042,588 |

During fiscal year 2014, power revenue bonds increased mainly as a result of the issuance of Series 2013A, with a principal amount of $675.1 million, net of related debt payments of principal and interest. Notes payable decreased $24.3 million mainly as a result of paying down revolving lines of credit to finance working capital.

The Authority's bond ratings were downgraded to "Caa3" by Moody's, "CC" by S&P and "CC" by Fitch.

Additional information on the Authority's long-term debt can be found in Notes 8 and 11 to the financial statements.

**Economic Factors and Next Year's Budgets and Rates**

In the last five years, Puerto Rico's economy has shown different behavior compared with the U.S economy in terms of the annual Gross Domestic Product (GDP). As published by the U.S Department of Commerce, the real GDP adjusted for price changes increased at an annual rate of 2.5% in the fourth quarter of 2014, according to the advance estimate released by the Bureau of Economic Analysis (BEA) in January 30, 2015. In the third quarter of 2014, real GDP figures increased 2.9%. Real GDP increased 2.4% in 2014, compared with an increase of 1.5% in 2013. According to IHS Global Insight (GI), the U.S economy will grow 3.5% in the period from January to March and 3.4% between October and December 2015. Projections for the years 2014 and 2015 estimate increases of 2.7% in 2014 and 3.3% in 2015.

By law, the Puerto Rico Planning Board (PRPB) is the local government agency that gathers and studies the official economic data. In Puerto Rico, the economy is measured by the Gross National Product (GNP). Puerto Rico's economy in fiscal year 2013 reached a real growth of 0.3%, compared to fiscal year 2012.

The Authority adopted the 2015 fiscal year budget on October 9, 2014. The total revenues for fiscal year 2014-2015 are projected to be approximately $4,630.7 million. In addition, the Capital Improvement Program amounted to approximately $244.7 million. The 2015 consolidated budget increased by $166.5 million (3.7 percent) when compared to the consolidated budget approved for fiscal year 2013-2014, mainly due to an increase in projected fuel oil prices per barrel from $94.96 for 2013-2014 to $108.48 for 2014-2015, representing a 14.2 percent increase.

**Request for Information**

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Authority's Chief Financial Officer. The executive offices of the Authority are located at 1110 Ponce de León Avenue, San Juan, Puerto Rico 00907.

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

## Statements of Net Position
*(In thousands)*

| | June 30 2014 | June 30 2013 |
|---|---|---|
| **Assets** | | *(as restated)* |
| Current assets: | | |
| Cash and cash equivalents | **$ 147,236** | $ 122,130 |
| Receivables, net | **1,500,545** | 1,394,199 |
| Fuel oil, at average cost | **194,073** | 323,730 |
| Materials and supplies, at average cost | **196,887** | 197,786 |
| Prepayments and other assets | **463** | 5,082 |
| Total current assets | **2,039,204** | 2,042,927 |
| | | |
| Other non-current receivables, net | **120,045** | 117,653 |
| | | |
| Restricted assets: | | |
| Cash and cash equivalents held by trustee for payment of principal and interest on bonds | **328,532** | 369,381 |
| Investments held by trustee | **674,395** | 553,602 |
| Construction fund and other special funds | **325,924** | 83,420 |
| Total restricted assets | **1,328,851** | 1,006,403 |
| | | |
| Utility plant: | | |
| Plant in service | **12,281,158** | 11,937,375 |
| Accumulated depreciation | **(6,422,226)** | (6,098,403) |
| | **5,858,932** | 5,838,972 |
| Construction in progress | **988,524** | 999,586 |
| Total utility plant, net | **6,847,456** | 6,838,558 |
| | | |
| Deferred expenses | **16,803** | 10,898 |
| Total assets | **10,352,359** | 10,016,439 |
| | | |
| **Deferred outflows of resources** | | |
| Accumulated decrease in fair value of hedging derivatives | **48,864** | 85,004 |
| Deferred loss resulting from debt refunding | **77,948** | 92,279 |
| Total deferred outflows of resources | **126,812** | 177,283 |
| Total assets and deferred outflows | **$ 10,479,171** | $ 10,193,722 |

*(Continued)*

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

## Statements of Net Position (continued)

*(In thousands)*

| | June 30 2014 | 2013 *(as restated)* |
|---|---|---|
| **Liabilities and net position** | | |
| Current liabilities: | | |
| Notes payable | **$ 733,908** | $ 755,665 |
| Accounts payable and accrued liabilities | **1,586,390** | 1,301,028 |
| Customers' deposits | **15,726** | 14,532 |
| Total current liabilities | **2,336,024** | 2,071,225 |
| | | |
| Current liabilities payable form restricted assets: | | |
| Current portion of long-term debt | **432,281** | 413,546 |
| Notes payable from restricted assets | **–** | 6,100 |
| Accrued interest | **218,839** | 187,432 |
| Other current liabilities payable from restricted assets | **60,614** | 39,594 |
| Total current liabilities payable from restricted assets | **711,734** | 646,672 |
| | | |
| Noncurrent liabilities: | | |
| Long-term debt, excluding current portion | **8,247,006** | 7,812,660 |
| Fair value of derivative instruments - interest, basis and commodity swaps | **48,864** | 85,004 |
| Customers' deposits (excluding current portion) | **168,855** | 166,950 |
| Sick leave benefits to be liquidated after one year | **114,518** | 122,356 |
| Accrued unfunded other post-employment benefits liability | **119,175** | 136,050 |
| Total noncurrent liabilities | **8,698,418** | 8,323,020 |
| Total liabilities | **11,746,176** | 11,040,917 |
| | | |
| Net position (deficit): | | |
| Invested in utility plant, net of related debt | **(253,448)** | (32,432) |
| Restricted for capital and debt service | **–** | – |
| Unrestricted | **(1,013,557)** | (814,763) |
| Total net position (deficit) | **(1,267,005)** | (847,195) |
| Total liabilities and net position | **$ 10,479,171** | $ 10,193,722 |

*See accompanying notes.*

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

## Statements of Revenues, Expenses and Changes in Net Position

*(In thousands)*

| | Year Ended June 30 | |
|---|---|---|
| | **2014** | **2013** |
| | | *(as restated)* |
| Operating revenues | **$ 4,468,922** | $ 4,843,016 |
| Operating expenses: | | |
| Operations: | | |
| Fuel | **2,345,000** | 2,603,577 |
| Purchased power | **807,620** | 755,686 |
| Other production | **70,557** | 72,384 |
| Transmission and distribution | **175,754** | 175,461 |
| Customer accounting and collection | **111,475** | 116,605 |
| Administrative and general | **192,031** | 201,663 |
| Maintenance | **201,944** | 218,950 |
| Depreciation | **341,511** | 344,653 |
| Total operating expenses | **4,245,892** | 4,488,979 |
| Operating income | **223,030** | 354,037 |
| Interest income and other | **21,157** | 26,329 |
| Income before interest charges, contribution in lieu of taxes and contributed capital | **244,187** | 380,366 |
| Interest charges: | | |
| Interest on bonds | **431,021** | 399,641 |
| Interest on notes payable and other long-term debt | **7,181** | 741 |
| Amortization of debt discount, issuance costs and refunding loss | **2,737** | 550 |
| Allowance for funds used during construction | **(9,759)** | (14,065) |
| Total interest charges, net | **431,180** | 386,867 |
| Loss before contribution in lieu of taxes and contributed capital | **(186,993)** | (6,501) |
| Contribution in lieu of taxes and other | **(277,776)** | (297,551) |
| Loss before contributed capital | **(464,769)** | (304,052) |
| Contributed capital | **44,959** | 31,979 |
| Change in net position | **(419,810)** | (272,073) |
| Net position (deficit), beginning balance, *as restated* | **(847,195)** | (575,122) |
| Net position (deficit), ending balance | **$ (1,267,005)** | $ (847,195) |

*See accompanying notes.*

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

# Statements of Cash Flows

*(In thousands)*

| | Year Ended June 30 | |
|---|---|---|
| | **2014** | **2013** |
| | | *(as restated)* |
| **Cash flows from operating activities** | | |
| Cash received from customers | **$ 4,176,780** | $ 4,665,529 |
| Cash paid to suppliers and employees | **(3,549,714)** | (4,272,003) |
| Net cash flows provided by operating activities | **627,066** | 393,526 |
| | | |
| **Cash flows from noncapital financing activities** | | |
| Proceeds from notes payable | **116,527** | 32,921 |
| Principal paid on notes payable | **(92,454)** | (92,053) |
| Interest paid on notes payable | **(1,163)** | (566) |
| Principal paid on fuel line of credit | **(1,630,600)** | (1,264,351) |
| Proceeds from fuel line of credit | **1,582,238** | 1,468,736 |
| Interest paid on fuel line of credit | **(27,197)** | (16,611) |
| Net cash flows (used in) provided by noncapital financing activities | **(52,649)** | 128,076 |
| | | |
| **Cash flows from capital and related financing activities** | | |
| Construction expenditures | **(288,746)** | (315,764) |
| Proceeds received from contributed capital | **4,358** | 10,898 |
| Power revenue bonds: | | |
| Proceeds from issuance of bonds, net of original discount | **658,336** | – |
| Principal paid on revenue bonds maturities | **(194,920)** | (185,605) |
| Interest paid on revenue bonds | **(409,847)** | (397,700) |
| Swap termination fees paid | **(37,873)** | – |
| Net cash flows used in capital and related financing activities | **(268,692)** | (888,171) |
| | | |
| **Cash flows from investing activities** | | |
| Purchases of investment securities | **(3,131,639)** | (4,085,709) |
| Proceeds from sale and maturities of investment securities | **3,012,296** | 4,165,974 |
| Interest on investments | **41,828** | 24,531 |
| Net cash flows (used in) provided by investing activities | **(77,515)** | 104,796 |
| Net increase (decrease) in cash and cash equivalents | **228,210** | (261,773) |
| | | |
| Cash and cash equivalents at beginning of year | **553,251** | 815,024 |
| Cash and cash equivalents at end of year | **$ 781,461** | $ 553,251 |

*(Continued)*

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

## Statements of Cash Flows (continued)

*(In thousands)*

| | Year Ended June 30 | |
|---|---|---|
| | **2014** | **2013** |
| | | *(as restated)* |
| **Cash and cash equivalents** | | |
| Unrestricted | **$ 147,236** | $ 122,130 |
| Restricted: | | |
| Cash and cash equivalents held by trustee for payment of principal and interest on bonds | **328,532** | 369,381 |
| Cash and cash equivalents within construction and other special funds | **305,693** | 61,740 |
| | **$ 781,461** | $ 553,251 |
| | | |
| **Reconciliation of operating income to net cash provided by operating activities** | | |
| Operating income | **$ 223,030** | $ 354,037 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | **341,511** | 344,653 |
| Provision for uncollectible accounts and other | **191,523** | 15,740 |
| Changes in assets and liabilities: | | |
| Receivables | **(334,556)** | (342,632) |
| Fuel oil | **156,854** | (78,438) |
| Materials and supplies | **899** | 580 |
| Prepayments and other assets | **4,619** | (5,027) |
| Other deferred debits | **(6,649)** | (6,881) |
| Noncurrent liabilities, excluding revenue bonds and notes payable | **(24,713)** | (12,210) |
| Accounts payable and accrued liabilities | **71,448** | 118,370 |
| Customer's deposits | **3,100** | 5,334 |
| Total adjustments | **404,036** | 39,489 |
| Net cash flows provided by operating activities | **$ 627,066** | $ 393,526 |
| | | |
| **Supplemental cash flows information** | | |
| Noncash transactions: | | |
| Capital contributions | **$ 40,601** | $ 21,081 |
| Change in fair value of derivative instruments | **$ 36,140** | $ 26,303 |
| Changes in deferred loss resulting from debt refunding | **$ (14,331)** | $ (15,062) |

*See accompanying notes.*

## 1. Reporting Entity

Puerto Rico Electric Power Authority (the Authority) is a public corporation and governmental instrumentality of the Commonwealth of Puerto Rico (the Commonwealth) created on May 2, 1941, pursuant to Act No. 83, as amended, re-enacted, and supplemented, of the Legislature of Puerto Rico (the Act) for the purpose of conserving, developing and utilizing the water, and power resources of Puerto Rico in order to promote the general welfare of the Commonwealth. Under the entity concept, the Authority is a component unit of the Commonwealth. The Authority transmits and distributes, substantially, all of the electric power consumed and produces a majority of the electricity generated in Puerto Rico.

The Authority has broad powers including, among others, to issue bonds for any of its corporate purposes subject to the limitations set forth in a Trust Agreement dated as of January 1, 1974, as amended (the 1974 Agreement). The Authority is required, under the terms of the 1974 Agreement and the Act, to determine and collect reasonable rates for electric service in order to produce revenues sufficient to cover all operating and financial obligations, as defined.

On August 18, 2003, the Commonwealth approved Act No. 189, which authorizes the Authority to create, acquire and maintain corporations, partnerships or subsidiary corporations, for profit or non-profit entities.

On May 27, 2014, the Commonwealth approved Act No. 57, which authorizes the Puerto Rico Energy Commission to approve electric rates proposed by the Authority among other matters.

### Basis of Presentation – Blended Component Units

The financial statements of the Authority as of the fiscal years ending June 30, 2014 and 2013, include the financial position and operations of the Puerto Rico Irrigation Systems (Irrigation Systems) and PREPA Holdings LLC (PREPA Holdings). The Irrigation Systems operate pursuant to the provisions of the Act, and Acts Nos. 83 and 84, approved on June 20, 1955, regarding the Puerto Rico Irrigation Service, South Coast, and Isabela Irrigation Service, respectively, and the Lajas Valley Public Irrigation Law, approved on June 10, 1953, as amended. PREPA Holdings, a wholly owned subsidiary of the Authority, was created for the sole purpose of acting as a holding company and has no current operations. PREPA Holdings is the direct parent of the following entities: PREPA Networks, LLC (PREPA.Net), Inter American Energy Sources, LLC, and Consolidated Telecom of Puerto Rico, LLC.

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

The Irrigations Systems and PREPA Holdings conform to the requirements of Governmental Accounting Standards Board (GASB) No. 61, *The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34*, and No. 39, *Determining Whether Certain Organizations are Component Units,* on its stand-alone financial statements. GASB No. 39 establishes standards for defining and reporting on the financial reporting entity. It also establishes standards for reporting participation in joint ventures. It applies to financial reporting by primary governments, and other stand-alone governments; and it applies to the separately issued financial statements of governmental component units. In addition, this Statement should be applied to governmental and non-governmental component units when they are included in a governmental financial reporting entity.

## 1. Reporting Entity (continued)

### Basis of Presentation – Blended Component Units (continued)

Condensed financial information as of June 30, 2014 and 2013 and for the fiscal years then ended for the Irrigation Systems is as follows:

| | **2014** | 2013 |
|---|---|---|
| | (*In thousands*) | |
| Statements of net position: | | |
| Assets: | | |
| Receivables, net | **$ 6,062** | $ 7,383 |
| Prepayments and other assets | **240** | 240 |
| Utility Plant, net of depreciation | **20,556** | 20,408 |
| Total assets | **$ 26,858** | $ 28,031 |
| Liabilities: | | |
| Accounts payable, net | **$ 1,066** | $ 1,066 |
| Statements of revenues, expenditures and changes in net position: | | |
| Operating revenues | **$ 6,284** | $ 6,875 |
| Operating expenses | **(7,457)** | (11,523) |
| | **(1,173)** | (4,648) |
| Transfer to primary government | **–** | (5,999) |
| Net position, beginning balance | **26,965** | 37,612 |
| Net position, ending balance | **$ 25,792** | $ 26,965 |

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

Pursuant to the Act, the Authority is authorized to create subsidiaries in order to, among other things, delegate or transfer any of its rights, powers, functions or duties. The Authority currently has four principal subsidiaries organized in a holding company structure.

PREPA Holdings, a wholly owned subsidiary of the Authority, was organized on October 26, 2009 as a Delaware limited liability company for the sole purpose of acting as a holding company and has no current operations. PREPA Holdings is the direct parent of the following entities: PREPA.Net, InterAmerican Energy Sources, LLC and Consolidated Telecom of Puerto Rico, LLC.

PREPA.Net, a subsidiary of the Company, was formed for the purpose of merging two local not-for-profit entities – PREPA Networks, Corp, and PREPA.Net International Wholesale Transport, Inc.

PREPA.Net markets the excess communication capacity of the Authority's fiber optic cable system. PREPA.Net currently offers next generation telecommunications services to carriers, internet service providers, and large commercial enterprises. These services include data transmission via Synchronous Optical Network (SONET), metro and long haul Ethernet transport services, wireless last mile, and internet protocol services optimized for voice over internet protocol. PREPA.Net also offers international fiber optic cable capacity and satellite teleport facilities through the submarine fiber optic cable capacity acquired in 2008.

InterAmerican Energy Sources, LLC was created on May 25, 2007, as a Delaware limited liability company, for the purpose of investing, developing, financing, constructing and operating renewable energy projects and other infrastructure related to the optimization of the Authority's electric infrastructure. InterAmerican Energy Sources, LLC is currently not operating.

Consolidated Telecom of Puerto Rico, LLC was created on October 27, 2009, as a Delaware limited liability company, for the purpose of developing, financing, constructing and operating a telecommunications business within or outside of the Commonwealth, directly or indirectly, in relation to the operations of the Authority.

## 1. Reporting Entity (continued)

### Basis of Presentation – Blended Component Units (continued)

Condensed financial information for PREPA Holdings, LLC as of June 30, 2014 and 2013 and for the year then ended is as follows:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| **Statement of net position:** | | |
| Assets: | | |
| Cash and cash equivalents | **$ 8,297** | $ 7,871 |
| Certificates of deposit | **1,638** | 1,635 |
| Receivables, net | **2,258** | 5,481 |
| Prepayments and other assets | **72** | 62 |
| Utility plant, net of depreciation | **29,356** | 16,869 |
| Other receivables | **11,086** | 14,623 |
| Total assets | **$ 52,707** | $ 46,541 |
| **Liabilities:** | | |
| Accounts payable, net | **$ 21,423** | $ 22,350 |
| Notes payable | **10,862** | 7,294 |
| Total liabilities | **$ 32,285** | $ 29,644 |
| **Statements of revenues, expenditures and changes in net position:** | | |
| Operating revenues | **$ 18,029** | $ 14,550 |
| Operating expenses | **(14,504)** | (10,438) |
| | **3,525** | 4,112 |
| Net position, beginning balance | **16,897** | 12,785 |
| **Net position, ending balance** | **$ 20,422** | $ 16,897 |

**1. Reporting Entity (continued)**

**Basis of Presentation – Blended Component Units (continued)**

| | | 2014 | | 2013 |
|---|---|---|---|---|
| | | *(In thousands)* | | |
| **Statement of cash flows:** | | | | |
| Cash flows from operating activities | **$** | **10,553** | $ | 6,707 |
| Cash flows from noncapital financing activities | | **4,428** | | (1,125) |
| Cash flows from capital and related financing activities | | **(14,567)** | | (11,136) |
| Cash flows from investing activities | | **12** | | 1,604 |
| Net increase in cash | | **426** | | (3,950) |
| Cash at beginning of year | | **7,871** | | 11,821 |
| Cash at end of year | **$** | **8,297** | $ | 7,871 |

**2. Summary of Significant Accounting Policies**

The following is a summary of the most significant accounting policies followed by the Authority in preparing its financial statements:

**Basis of Accounting**

The accounting and reporting policies of the Authority conform to the accounting rules prescribed by the Governmental Accounting Standards Board (GASB). As such, it functions as an enterprise fund. The Authority maintains its accounting records on the accrual basis of accounting in conformity with U.S. generally accepted accounting principles. Although the Authority is not subject to all Federal Energy Regulatory Commission (FERC) regulations, the Authority has adopted the uniform system of accounts prescribed by FERC.

The accounting and reporting policies of the Authority conform to the accounting rules prescribed by the Governmental Accounting Standards Board (GASB).

## 2. Summary of Significant Accounting Policies (continued)

### Basis of Accounting (continued)

The Authority accounts for its operations and financings in a manner similar to private business enterprises; the intent is that costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Such accounts and these financial statements have been prepared on the basis that the Authority will continue as a going concern. Additional disclosures within the Notes to these financial statements, particularly in Notes 8, 11, 19 and 20, should be read in connection with consideration of the future ability of the Authority to continue as such.

### Cash and Cash Equivalents

The Authority considers all highly liquid debt instruments with maturities of three months or less when purchased to be cash equivalents. Cash and cash equivalents included in the restricted funds are considered cash equivalents for purposes of the statements of cash flows.

### Receivables

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined, based upon past collection experience and current economic conditions, among other factors. The Authority establishes a general or specific reserve for each group of customers (i.e., residential, commercial, industrial, and governmental). The Authority has significant amounts receivable from the Commonwealth's and its instrumentalities. There is significant uncertainty in regards to the collection of such receivables due to the financial challenges these entities are facing. The Authority has considered this in its estimate of the specific governmental reserve for uncollectible accounts. 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.

### Materials, Supplies and Fuel Oil

Materials, supplies and fuel oil inventories are carried at average cost and are stated at the lower of cost or market.

## 2. Summary of Significant Accounting Policies (continued)

### Investments

The Authority follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, which require the reporting of investments at fair value in the statement of net position and recording changes in fair value in the statements of revenues, expenses and changes in net position. The fair value is based on quoted market prices and recognized pricing services for certain fixed income securities.

The funds under the 1974 Agreement may be invested in:

- Government obligations, which are direct obligations of, or obligations whose principal and interest is guaranteed by the U.S. Government, or obligations of certain of its agencies or instrumentalities.

- Investment obligations of any of the states or territories of the United States or political subdivisions thereof (other than obligations rated lower than the three highest grades by a nationally recognized rating agency) and repurchase agreements with commercial banks fully secured by U.S. Government obligations.

- Time deposits with Government Development Bank for Puerto Rico (GDB) or the Authority’s Trustee under the 1974 Agreement or any bank or trust company member of the Federal Deposit Insurance Corporation having a combined capital and surplus of not less than $100 million.

Effective April 1999, the 1974 Agreement was amended to provide that permitted investments of moneys to the credit of the Self-insurance Fund be expanded (subject to the Authority’s adoption of an investment policy with the consent of GDB) to coincide with the investments permitted for the pension fund for employees of the Commonwealth of Puerto Rico and its instrumentalities.

Such investments include various debt instruments, such as mortgage loans and leases, common and preferred stock, real property and various other financial instruments.

**2. Summary of Significant Accounting Policies (continued)**

**Utility Plant**

Utility plant is carried at cost, which includes labor, materials, overhead, and an allowance for the cost of funds used during construction (AFUDC). AFUDC represents the cost of borrowed funds used to finance construction work in progress. AFUDC is capitalized as an additional cost of property and as a reduction of interest expense. Capitalized interest expense is reduced by interest income earned on related investments acquired with proceeds of tax-exempt borrowings. Such costs are recovered from customers as a cost of service through depreciation charges in future periods. Capitalized interest during the years ended June 30, 2014 and 2013 amounted to $9.8 million and $14.1 million, respectively. These amounts are net of interest income earned on investments amounting to $4.0 million and $1.0 million, respectively.

Capital expenditures of $1,200 or more are capitalized at cost at the date of acquisition. Maintenance, repairs, and the cost of renewals of minor items of property units are charged to operating expenses. Replacements of major items of property are charged to the plant accounts. The cost of retired property, together with removal cost less salvage, is charged to accumulated depreciation with no gain or loss recognized.

The Authority follows the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.* This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

**Depreciation**

Depreciation is computed on the straight-line method at rates considered adequate to allocate the cost of the various classes of property over their estimated service lives. The annual composite rate of depreciation, determined by the Authority's consulting engineers, was approximately 3.58% for 2014 and 2013.

**Unamortized Debt Issuance Expense**

Debt issuance costs are presented as expense during the year they are incurred. Premium and discounts incurred in the issuance of bonds are deferred and amortized using the straight-line method, which approximates the interest method, over the term of the related debt.

**2. Summary of Significant Accounting Policies (continued)**

**Unamortized Debt Issuance Expense (continued)**

For debt refunding debt, the excess of reacquisition cost over the carrying value of long-term debt is deferred and amortized to operating expenses using the straight-line method over the remaining life of the original debt or the life of the new debt, whichever is shorter.

Bonds payable are reported net of applicable bond premium or discount. For fiscal year 2013 and 2014, as a result of the adoption of GASB Statement No. 65, the deferred loss from debt refunding is reported as deferred outflows of resources in the accompanying statements of net position.

**Pension Plan and Other Postemployment Benefits**

Pension and other postemployment benefits (OPEB) expenses are equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and actual contributions.

**Accounting for Compensated Absences**

Employees earn annual vacation leave at the rate of 30 days per year up to a maximum permissible accumulation of 60 days for union employees and management personnel.

Employees accumulate sick leave at the rate of 19 days per year. Sick leave is only payable if the regular employee resigns and has more than 10 years of employment, or retires and takes a pension. Maximum permissible accumulation for sick leave is 90 days for all employee and the excess shall be lost if an employee does not use such excess from January to June of the next year.

The Authority records as a liability and as an expense the vested accumulated vacation and sick leave as benefits accrue to employees. The cost of vacation and sick leave expected to be paid in the next twelve months is classified as current and accrued liabilities while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

## 2. Summary of Significant Accounting Policies (continued)

### Revenue Recognition, Fuel Costs and Purchased Power

Clients are billed monthly. Revenues are recorded based on services rendered during each accounting period, including an estimate for unbilled services. Revenues include amounts resulting from a fuel and purchased power cost recovery clause (Fuel Adjustment Clause), which is designed to permit full recovery through customer billings of fuel costs and purchased power. Fuel costs and purchased power are reflected in operating expenses as the fuel and purchased power are consumed.

### Contributions in Lieu of Taxes and Governmental Subsidies

The Act exempts the Authority from all taxes that otherwise would be levied on its properties and revenues by the Commonwealth and its Municipalities, except to the extent net revenues, as defined, are available, wherein the Authority is required under the Act to make a contribution in lieu of taxes of 11% to the Commonwealth and the Municipalities of gross electric sales as follows:

*Municipalities*

The Authority is required under the Act to make a contribution in lieu of taxes to municipalities of the greater of:

a) Twenty percent of the Authority's Adjusted Net Revenues (Net Revenues, as defined in the 1974 Agreement, less the cost of the Commonwealth rate subsidies);
b) The cost collectively of the actual electric power consumption of the municipalities; or
c) The prior five-year moving average of the contributions in lieu of taxes paid to the municipalities collectively.

If the Authority does not have sufficient funds available in any year to pay the contribution in lieu of taxes, the difference is accrued and carried forward for a maximum of three years. The contribution in lieu of taxes to Municipalities can be used to offset accounts receivable balance owed by the Municipalities to the Authority as permitted by law.

## 2. Summary of Significant Accounting Policies (continued)

### Contributions in Lieu of Taxes and Governmental Subsidies (continued)

#### *Commonwealth of Puerto Rico*

To the extent net revenues are available, the Authority is also required under the Act to set aside the remainder of contribution in lieu of taxes of gross electric sales for the purpose of (i) financing capital improvements, (ii) offsetting other subsidies (other than cost of fuel adjustments to certain residential clients) of the Commonwealth, and (iii) any other lawful corporate purpose. Amounts assigned to (ii) above, are classified as a contribution in lieu of taxes in the accompanying statements of revenues, expenses and changes in net position and reduce the related accounts receivable in the statements of net position.

### Contributed Capital

The Authority records contributed capital as income in the year earned. The Authority receives contributed capital in the form of cash and property from residential projects developed by third parties during recent years and local and federal agencies. During the years ended June 30, 2014 and 2013, the Authority received non-cash contributed capital in the amount of $40,601 and $21,081, respectively.

### Risk Management

The Authority purchases commercial insurance covering casualty, theft, tort claims, natural disaster and other claims covering all risk property (excluding transmission and distribution lines), boiler and machinery, boiler, machinery and public liability. In addition, the Authority has a self-insured fund to pay the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of a cause, which is not covered by insurance required under 1974 agreement.

**2. Summary of Significant Accounting Policies (continued)**

**Estimates**

The preparation of the basic financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets (including related allowances for uncollectible accounts) and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Interest-Rate Swap Agreements**

The Authority follows the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This statement establishes guidance for the recognition, measurement, and disclosure of information regarding derivative instruments.

The interest-rate swaps are used in the area of debt management to take advantage of favorable market interest rates and to limit interest rate risk associated with variable rate debt exposure.

Under the interest-rate swap programs, the Authority pays fixed and variable rates of interest based on various indices for the term of the variable interest rate Power Revenue Bonds and receives a variable rate of interest, which is also based on various indices. These indices are affected by changes in the market. The net amount received or paid under the swap agreements is recorded as an adjustment to interest expense on the statements of revenues, expenses and changes in net position. The interest rate swaps are reported at fair value in the Statement of Net Positions. The changes in fair value for effective hedges are recorded as deferred inflows or outflows of resources in the Statement of Net Positions. The changes in fair value for ineffective hedges are reported in investment income.

The Authority accounts for its derivative instruments at fair value. The changes in fair values of the effective hedging derivative instruments are reported as either deferred inflows or deferred outflows of resources. The changes in fair value of investment derivative instruments (which include ineffective hedging derivative instruments) are reported as part of investment income in the current reporting period.

## 2. Summary of Significant Accounting Policies (continued)

### Restricted Assets

Funds set aside for construction, debt service payments or other specific purposes are classified as restricted assets since their use is limited for these purposes by the applicable agreements.

When both restricted and unrestricted resources are available for a specific use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

### Claims and Judgment

The estimated amount of the liability for claims and judgments is recorded on the accompanying statement of net position based on the Authority's evaluation of the probability of an unfavorable outcome in the litigation of such claims and judgments. 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 claims and judgments may change in the future.

## 3. Cash and Cash Equivalents

The 1974 Agreement established the General Fund, the Revenue Fund, and certain other funds (see Note 5). All revenues (other than income from investments and construction funds obtained from financing) are deposited in these funds. The moneys held in these funds are presented as unrestricted cash and cash equivalents in the statement of net position.

### 3. Cash and Cash Equivalents (continued)

At June 30, 2014 and 2013, the carrying amount and bank balance of cash deposits held by the Authority and restricted cash deposits held by the Trustee under the 1974 Agreement are as follows (in thousands):

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Carrying Amount** | **Bank Balance** | **Carrying Amount** | **Bank Balance** |
| Unrestricted | **$147,236** | **$158,517** | $122,130 | $49,499 |
| Restricted: | | | | |
| Held by the Trustee | **328,532** | **328,532** | 369,381 | 369,381 |
| Held by the Authority | **305,693** | **305,693** | 61,740 | 61,740 |
| | **$781,461** | **$792,742** | $553,251 | $480,620 |

### Custodial Credit Risk - Deposits

Custodial credit risk is the risk that in the event of a bank failure, the Bank's deposits may not be returned. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized. Deposits maintained in GDB or the Economic Development Bank (EDB) are exempt from the collateral requirements established by the Commonwealth and thus represents custodial credit risk because in the event of GDB's or EDB's failure the Authority may not be able to recover the deposits. The Authority's policy is to deposit funds with either institution which provides insurance or securities as collateral. Such collateral is held by the Department of the Treasury of the Commonwealth.

All moneys deposited with the Trustee or any other Depository hereunder in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other federal agency are continuously secured by lodging with a bank or trust company approved by the Authority and by the Trustee as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit, as collateral security, Government Obligations or other marketable securities.

## 4. Accounts Receivable

At June 30, receivables consist of (in thousands):

| | 2014 | 2013 |
|---|---|---|
| Current: | | |
| Electric and related services: | | |
| Government agencies and municipalities | **$ 638,637** | $ 499,996 |
| Residential, industrial, and commercial | **928,277** | 884,776 |
| Recoveries under fuel adjustment clause under billed | **67,766** | 10,144 |
| Unbilled services | **220,104** | 195,278 |
| Miscellaneous accounts and others | **9,334** | 14,611 |
| | **1,864,118** | 1,604,805 |
| Allowance for uncollectible accounts - current | **(397,705)** | (251,283) |
| | **1,466,413** | 1,353,522 |
| Receivable from insurance companies and other | **29,818** | 37,819 |
| Accrued interest on investments | **4,314** | 2,858 |
| | **$1,500,545** | $1,394,199 |
| Noncurrent: | | |
| Electric and related services: | | |
| Government agencies and municipalities | **$ 165,090** | $ 117,653 |
| Allowance for uncollectible accounts – noncurrent | **(45,045)** | – |
| | **$ 120,045** | $ 117,653 |

The Authority has other subsidies and reimbursable costs receivable from the Commonwealth, which are reduced by means of charges (accounted for as a contribution in lieu of taxes and to the extent net revenues, as defined, are available) against a portion of the 11% of gross electric sales, after the contribution in lieu of taxes to municipalities, it is required to set aside under the Act. The Authority has the right to offset amounts receivable from municipalities amounting to $555 million and $321 million as of June 30, 2014 and 2013, respectively with contribution in lieu of taxes payable to such municipalities. The portion of accounts receivable and other governmental receivables not expected to be collected during the next fiscal year are reflected in the accompanying statement of net position as other noncurrent receivables. Further, the Authority has recorded an allowance for uncollectible accounts estimated at $68 million and $12 million, for 2014 and 2013, respectively, in consideration of the financial difficulty being experienced by the Commonwealth and related entities and the risk receivables (both current and long term) from such entities are uncollectible.

## 5. Restricted Assets

At June 30, 2014 and 2013, certain investments and cash deposits of the Authority were restricted to comply with long-term principal and interest debt service requirements (sinking funds) as well as for self-insurance. These restricted assets are held by the Trustee under the 1974 Agreement (see Note 3) in the following funds:

*1974 Reserve Account* – Reserve for payment of principal of and interest on Power Revenue Bonds in the event moneys in Bond Service Account or Redemption Account are insufficient for such purpose. During fiscal year 2013-2014, the Authority deposited $46.4 million into 1974 Reserve Account from the proceeds of Power Revenue Bonds Series 2013 A.

*1974 Self-Insurance Fund* – Fund to pay the cost of repairing, replacing or reconstructing any property damaged or destroyed from, or extraordinary expenses incurred as a result of a cause, which is not covered by insurance required under the 1974 Agreement. The 1974 Self-Insurance Fund also serves as an additional reserve for the payment of the principal of and interest on the Power Revenue Bonds, and meeting the amortization requirements to the extent that moneys in the Bond Service Account, the Redemption Account and the 1974 Reserve Account are insufficient for such purpose. The Authority did not make any deposits into the 1974 Self Insurance Fund during fiscal years 2012-2013 and 2013-2014.

*Bond Service Account and Redemption Account* (1974 Sinking Fund) – Current year requirements for principal of and interest on Power Revenue Bonds. The Authority did not make required deposits into 1974 Sinking Fund Principal and Interest for May 2014.

Please see further discussion regarding the forbearance agreements in Note 20.

**5. Restricted Assets (continued)**

At June 30, cash, cash equivalents and investments held by the Trustee consist of (in thousands):

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | **Cash and Cash Equivalents** | **Investments** | **Cash and Cash Equivalents** | **Investments** |
| 1974 Sinking Fund - Principal | **$188,508** | **$ –** | $194,920 | $ 569 |
| 1974 Sinking Fund – Interest and Capitalized Interest | **140,024** | **124,992** | 174,461 | 62,344 |
| 1974 Reserve Account | **–** | **453,323** | – | 398,472 |
| 1974 Self-Insurance Fund | **–** | **96,080** | – | 92,217 |
| | **$328,532** | **$674,395** | $369,381 | $553,602 |

Investments held by Trustee under the 1974 Agreement are invested exclusively in securities of the U.S. Government and its agencies.

The Authority also has cash and investment securities held by the trust department of a commercial bank restricted for the following purposes:

*1974 Construction Fund* – Special fund created by the 1974 Agreement. The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of acquiring or constructing improvements, together with the money received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the 1974 Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the 1974 Construction Fund and held by the Authority in trust. During fiscal year 2013-2014, the Authority deposited $500 million into 1974 Construction Fund from the proceeds of Power Revenue bonds Series 2013 A.

*Reserve Maintenance Fund* – Fund to pay the cost of unusual or extraordinary maintenance or repairs, not recurring annually, and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of principal and interest on the Power Revenue Bonds and meeting the amortization requirements to the extent that moneys in the 1974 Sinking Fund, including money in the 1974 Reserve Account, are insufficient for such purpose. The Authority did not make any deposits into the 1974 Reserve Maintenance Fund during fiscal years 2014 and 2013.

**5. Restricted Assets (continued)**

At June 30, 2014 and 2013, the 1974 Construction Fund, Reserve Maintenance Fund and other restricted funds consist of (in thousands):

| | 2014 | | 2013 | |
|---|---|---|---|---|
| | Cash and Cash Equivalents | Investments | Cash and Cash Equivalents | Investments |
| 1974 Construction Fund | **$303,793** | **$ 1,105** | $49,370 | $ 1,103 |
| Reserve Maintenance Fund | **–** | **15,949** | – | 15,818 |
| Other Restricted Funds | **1,900** | **–** | 12,370 | – |
| PREPA Client Fund | **–** | **3,177** | – | 4,759 |
| | **$305,693** | **$20,231** | $61,740 | $21,680 |

Following is the composition of the investments in the 1974 Construction Fund and other special funds (in thousands):

| | 2014 | 2013 |
|---|---|---|
| U.S. Government obligations | **$ 1,105** | $ 1,103 |
| Certificate of deposit | **19,126** | 20,577 |
| | **$20,231** | $21,680 |

## 5. Restricted Assets (continued)

## Investments

The following table provides a summary of the Authority's investments by type at June 30, 2014 (in thousands):

**June 30, 2014**

| | Coupon Rate | Maturity Dates | Face Value | Fair Value | % of Total Portfolio |
|---|---|---|---|---|---|
| **1974 Reserve Maintenance Fund** | | | | | |
| Federal Home Loan Bank | 0.87% | 05/12/17 | $ 5,000 | $ 5,011 | 31.4% |
| Federal Home Loan Mortgage Corp. | 1.00% | 06/26/17 | 5,000 | 5,007 | 31.4% |
| Certificate of Deposits | Various | 08/29/14 | 5,931 | 5,931 | 37.2% |
| | | | Total Portfolio | 15,949 | |
| **1974 Self Insurance Fund** | | | | | |
| Federal Home Loan Mortgage Corp. | .90 to 6.50% | 12/2017 to 11/2028 | 8,443 | 8,791 | 9.1% |
| Federal Home Loan Bank | .87 to 1.625% | 03/2017 to 04/2017 | 30,675 | 30,642 | 31.9% |
| Federal National Mortgage Association | .50 to 6.00% | 05/2016 to 03/2030 | 12,436 | 13,152 | 13.7% |
| Federal Farm Credit Bank | 0.87% | May-17 | 15,000 | 15,034 | 15.6% |
| Corporate Issues | .03 to 5.75% | 07/2014 to 05/2024 | 3,057 | 3,258 | 3.4% |
| U.S. Bank Money Market | 0.30% | Aug-14 | 387 | 387 | 0.4% |
| U.S. Treasury Note | 2.00 to 4.75% | 08/2017 to 02/2022 | 6,710 | 6,821 | 7.1% |
| U.S. Treasury Bonds | 1.75 to 8.13% | 08/2021 to 05/2022 | 4,185 | 4,206 | 4.4% |
| Domestic Common Stocks | Various | Various | 9,316 | 12,252 | 12.8% |
| Certificate of Deposit | Various | Aug-13 | 1,538 | 1,537 | 1.6% |
| | | | Total Portfolio | 96,080 | |
| **1974 Reserve Account** | | | | | |
| Federal Home Loan Mortgage Corporation | .90 to 5.00% | 02/2016 to 12/2017 | 48,980 | 48,856 | 10.8% |
| Federal Home Loan Bank | .95 to 2.00% | 01/2018 to 04/2019 | 15,000 | 14,893 | 3.3% |
| Federal National Mortgage Association | .813 to 5.00% | 01/2017 to 12/2018 | 51,202 | 53,545 | 11.8% |
| Federal Farm Credit Bank | .082 to 2.28% | 02/2017 to 04/2019 | 37,000 | 36,947 | 8.1% |
| U.S. Bank Money Market | .03 to .04% | Various | 2,354 | 2,354 | 0.5% |
| U.S. Treasury Note | .50 to 4.625% | 08/2016 to 02/2018 | 50,145 | 50,817 | 11.2% |
| Corporate Issues | .25 to 4.00% | 01/2014 to 04/2018 | 14,960 | 15,521 | 3.4% |
| Certificates of Deposits | .20 to 1.00% | Various | 230,390 | 230,390 | 50.8% |
| | | | Total Portfolio | 453,323 | |
| **Sinking Fund - Capitalized Interest** | | | | | |
| Federal Home Loan Mortgage Corporation | .625 to .75% | 11/2014 to 12/2014 | 1,800 | 1,804 | 1.4% |
| Federal National Mortgage Association | .75 to 2.625% | 11/2014 to 12/2014 | 4,000 | 4,019 | 3.2% |
| U.S. Bank Money Market | 0.300% | Various | 35,022 | 35,022 | 28.0% |
| Certificates of Deposits | 1.20 to 1.90% | 12/2014 to 12/2015 | 69,658 | 69,658 | 55.7% |
| Municipal Issues | .515to 5.50% | 07/2014 to 12/2023 | 14,410 | 14,489 | 11.6% |
| | | | Total Portfolio | 124,992 | |
| **1974 PREPA Client** | | | | | |
| Certificates of Deposits | | | 3,177 | 3,177 | 100.0% |
| | | | Total Portfolio | 3,177 | |
| **1974 Construction Fund** | | | | | |
| Other - Rural Electrification Administration (REA) | | | 1,105 | 1,105 | 100.0% |
| | | | Total Portfolio | 1,105 | |
| | | | | $ 694,626 | |

## 5. Restricted Assets (continued)

### Investments (continued)

The following table provides a summary of the Authority's investments by type at June 30, 2013 (in thousands):

| June 30, 2013 | Coupon Rate | Maturity Dates | Face Value | Fair Value | % of Total Portfolio |
|---|---|---|---|---|---|
| **1974 Reserve Maintenance Fund** | | | | | |
| Federal National Mortgage Association | 0.52% | 16-Feb | $ 5,000 | $ 4,972 | 31.4% |
| Federal Farm Credit Bank | 0.44% | 15-Oct | 5,000 | 4,983 | 31.5% |
| Certificate of Deposits | 0.15% | 13-Sep | 5,863 | 5,863 | 37.1% |
| | | | Total Portfolio | 15,818 | |
| **1974 Self Insurance Fund** | | | | | |
| Federal Home Loan Mortgage Corp. | 5.00 to 6.50% | 08/2021 to 11/2028 | 4,294 | 4,642 | 5.0% |
| Federal National Mortgage Association | .52 to 6.00% | 02/2016 to 03/2030 | 20,432 | 21,186 | 23.0% |
| Federal Farm Credit Bank | .42 to .45% | 10/2015 to 05/2016 | 45,000 | 44,724 | 48.5% |
| Corporate Issues | 3.45 to 8.50% | 12/2017 to 02/2023 | 8,770 | 9,387 | 10.2% |
| U.S. Bank Money Market | 0.10% | 13-Aug | 754 | 754 | 0.8% |
| U.S. Treasury Note | 8.13% | 21-Aug | 290 | 429 | 0.5% |
| Domestic Common Stocks | Various | Various | 8,549 | 9,787 | 10.6% |
| Certificate of Deposit | 0.140% | 13-Aug | 1,309 | 1,308 | 1.4% |
| | | | Total Portfolio | 92,217 | |
| **1974 Reserve Account** | | | | | |
| Federal Home Loan Mortgage Corporation | .90 to 5.00% | 02/2016 to 12/2017 | 48,195 | 47,688 | 12.0% |
| Federal Home Loan Bank | .05 to 5.625% | 02/2015 to 06/2018 | 24,431 | 25,097 | 6.3% |
| Federal National Mortgage Association | .50 to 4.625% | 10/2013 to 08/2021 | 78,677 | 80,532 | 20.2% |
| Federal Farm Credit Bank | .235 to 1.08% | 05/2013 to 02/2018 | 25,700 | 25,193 | 6.3% |
| U.S. Bank Money Market | .04 to .10% | Various | 4,421 | 4,421 | 1.1% |
| U.S. Treasury Note | .25 to 4.625% | 03/2014 to 02/2018 | 122,915 | 122,874 | 30.9% |
| Corporate Issues | .30 to 6.375% | 07/2013 to 06/2018 | 72,595 | 74,873 | 18.8% |
| Certificates of Deposits | .25 to .45% | 13-Jul | 17,794 | 17,794 | 4.5% |
| | | | Total Portfolio | 398,472 | |
| **1974 Sinking Fund – Principal** | | | | | |
| U.S. Bank Money Market | 0.040% | 13-Jul | 569 | 569 | 100.0% |
| | | | Total Portfolio | 569 | |
| **Sinking Fund - Capitalized Interest** | | | | | |
| Federal Home Loan Mortgage Corporation | .625 to .75% | 11/2014 to 20/2014 | 1,800 | 1,808 | 3.9% |
| Federal National Mortgage Association | .75 to 4.625% | 10/2013 to 12/2014 | 7,530 | 7,586 | 16.3% |
| U.S. Bank Money Market | 0.100% | 08/2013 to 09/2013 | 2,268 | 2,268 | 4.9% |
| Municipal Issues | .30 to 6.875% | 07/2013 to 01/2015 | 49,750 | 50,182 | 108.2% |
| Corporate Issues | 0.438% | 13-Nov | 500 | 500 | 1.1% |
| | | | Total Portfolio | 62,344 | |
| **1974 PREPA Client** | | | | | |
| Certificates of Deposits | | | | 4,759 | 100.0% |
| | | | Total Portfolio | 4,759 | |
| **1974 Construction Fund** | | | | | |
| Other - Rural Electrification Administration (REA) | | | | 1,103 | 100.0% |
| | | | Total Portfolio | 1,103 | |
| | | | | $ 575,282 | |

## 5. Restricted Assets (continued)

### Credit Risk

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. The 1974 Trust Agreement limits investments in:

- Government obligations, which are direct obligations of or obligations whose principal and interest is guaranteed by the U.S. Government, or obligation of certain of its agencies or instrumentalities.

- Investment obligation of any of the states or territories of the United States or political subdivisions therefore (other than obligations rated lower than the three highest grades by a nationally recognized rating agency) and repurchase agreements with commercial banks fully secured by U.S. Government Obligations.

- Time deposits with GDB or the Authority's Trustee under the 1974 Agreement or any bank or trust company member of the Federal Deposit Insurance Corporation having a combined capital and surplus of not less than $100 million.

- Self-insurance fund (sinking fund) and PREPA client fund are allowed to invest in corporate issues, with certain restrictions (40% of the total fixed income portfolio).

As of June 30, 2014, the Authority's investments in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association and Federal Farm Credit Bank and Freddie Mac were rated AA+ by Standard & Poor's (S&P) and Aaa by Moody's Investors Service.

### Concentration Credit Risk

Concentration of credit risk is the risk of loss attributable to the magnitude of investment in a single issuer by five percent or more of total investment. The Authority's investment policy does not contain a limitation to invest in the securities of single issuer. As of June 30, 2014, more than 5% of the Authority's total investments are in Federal Home Loan Mortgage, Federal Home Loan Bank, Federal National Mortgage Association, Federal Farm Credit Bank, and Certificate of Deposits.

## 5. Restricted Assets (continued)

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of the Authority's investment to market interest fluctuations is provided by the following tables that show the distribution of the investments by maturity as of June 30, 2014 and 2013 (in thousands):

**June 30, 2014**

| | | Investment Maturities | | | |
|---|---|---|---|---|---|
| **Investment Type** | **Fair Value** | **Less than 1 year** | **1-5 years** | **More than 5 years** | **Total** |
| Federal Home Loan Mortgage Corporation | $ 64,458 | $ 1,804 | $ 58,360 | $ 4,294 | $ 64,458 |
| Federal Home Loan Bank | 50,546 | – | 50,546 | – | 50,546 |
| Federal National Mortgage Association | 70,715 | 4,019 | 45,510 | 21,186 | 70,715 |
| Federal Farm Credit Bank | 51,981 | – | 46,211 | 5,770 | 51,981 |
| Certificate of Deposits | 310,694 | 310,694 | – | – | 310,694 |
| Other-REA Investment | 1,105 | – | 1,105 | – | 1,105 |
| US Treasury Note | 57,638 | – | 57,638 | – | 57,638 |
| US Treasury Bonds | 4,206 | | 4,206 | – | 4,206 |
| US Bank Money Market | 37,763 | 37,763 | – | – | 37,763 |
| Municipal Issues | 14,489 | 14,184 | 305 | – | 14,489 |
| Domestic Common Stocks | 12,252 | – | 12,252 | – | 12,252 |
| Corporate Issues | 18,779 | 14,871 | 3,908 | – | 18,779 |
| Total Investments | | | | | $ 694,626 |

## 6. Utility Plant

As of June 30, utility plant consists of:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Distribution | **$ 3,996,392** | $ 3,770,419 |
| Transmission | **2,242,637** | 2,168,381 |
| Production | **2,830,980** | 2,764,986 |
| Other production | **1,534,943** | 1,472,402 |
| Hydroelectric | **139,266** | 136,182 |
| General | **1,465,866** | 1,563,236 |
| Irrigation systems | **34,824** | 34,324 |
| Fiber Network | **36,250** | 27,445 |
| | **12,281,158** | 11,937,375 |
| Less accumulated depreciation | **(6,422,226)** | (6,098,403) |
| | **5,858,932** | 5,838,972 |
| Construction in progress | **988,524** | 999,586 |
| | **$ 6,847,456** | $ 6,838,558 |

## 6. Utility Plant (continued)

Utility plant activity for the fiscal years ended June 30, 2014 and 2013 was as follows (in thousands):

| | **2013 Beginning Balance** | **Increases** | **Decreases** | **Transfers** | **2014 Ending Balance** |
|---|---|---|---|---|---|
| Utility plant | **$ 11,937,375** | **$ –** | **$ (17,688)** | **$ 361,471** | **$ 12,281,158** |
| Construction work in progress | **999,586** | **350,409** | **–** | **(361,471)** | **988,524** |
| Total utility plant, *as restated* | **12,936,961** | **350,409** | **(17,688)** | **–** | **13,269,682** |
| Less: | | | | | |
| Accumulated depreciation | **(6,098,403)** | **(341,511)** | **17,688** | **–** | **(6,422,226)** |
| Total utility plant, *net as restated* | **$ 6,838,558** | **$ 8,898** | **$ –** | **$ –** | **$ 6,847,456** |

| | **2012 Beginning Balance** | **Increases** | **Decreases** | **Transfers** | **2013 Ending Balance** |
|---|---|---|---|---|---|
| Utility plant | $ 11,703,301 | $ – | $ (14,345) | $ 248,419 | $ 11,937,375 |
| Construction work in progress | 863,970 | 384,035 | – | (248,419) | 999,586 |
| Total utility plant | 12,567,271 | 384,035 | (14,345) | – | 12,936,961 |
| Less: | | | | | |
| Accumulated depreciation | (5,768,095) | (344,653) | 14,345 | – | (6,098,403) |
| Total utility plant, *net* | $ 6,799,176 | $ 39,382 | $ – | $ – | $ 6,838,558 |

Construction work in progress at June 30, 2014 and 2013 consists principally of expansions and upgrades to the electric generation, distribution and transmission systems.

## 7. Defeasance of Debt

In prior years, the Authority has refunded in advance certain Power Revenue Bonds and other obligations by placing the proceeds of new debt in an irrevocable trust to provide for future debt service payments on such bonds. Accordingly, the trust accounts, assets, and liabilities for the defeased bonds are not included in the Authority's financial statements. At June 30, 2014, $3.7 million of Power Revenue Bonds which remain outstanding were considered defeased.

## 8. Notes Payable

The following is a summary of notes payable as of June 30, 2014 (in thousands):

| June 30, 2014 | Maturity Date | Effective Interest Rate | Current Liabilities | Long-Term Debt | Total |
|---|---|---|---|---|---|
| Notes payable, unrestricted: | | | | | |
| Revolving line of credit of $250 million to finance working capital | **Jan-15** | **7.25%** | **$ 146,042** | **$ –** | **$ 146,042** |
| Revolving line of credit of $500 million to finance working capital | **Aug-14** | **7.25%** | **549,976** | **–** | **549,976** |
| Line of credit of $25 million to finance improvements to Isabela Irrigation System | **Jun-18** | **7.00% (F)** | **743** | **–** | **743** |
| Revolving line of credit of $100 million to fund swap's collateral posting | **Dec-14** | **6.00% (F)** | **35,136** | **–** | **35,136** |
| P.R. (ULTRACOM) | **Feb-23** | **3.25% (V)** | **842** | **6,452** | **7,294** |
| PREPA Holdings (IT Solution) | **May-17** | **3.50% (F)** | **1,169** | **4,410** | **5,579** |
| Total notes payable | | | **$ 733,908** | **$ 10,862** | **$ 744,770** |

(V) – *variable interest rate*
(F) – *fixed interest rate*

## 8. Notes Payable (continued)

The following is a summary of notes payable as of June 30, 2013 (in thousands):

| June 30, 2013 | Maturity Date | Effective Interest Rate | Current Liabilities | Long-Term Debt | Total |
|---|---|---|---|---|---|
| Notes payable, unrestricted: | | | | | |
| Line of credit of $64.2 million to fund payments required under a settlement agreement with municipalities | Jun-14 | .70%+LIBOR (V) | $ 9,700 | $ – | $ 9,700 |
| Revolving line of credit of $250 million to finance working Capital | Oct-14 | 2.80%+LIBOR (V) | 249,138 | – | 249,138 |
| Revolving line of credit of $500 million to finance working Capital | Aug-14 | 2.25%+LIBOR (V) | 495,242 | – | 495,242 |
| Line of credit of $25 million to finance improvements to Isabela Irrigation System | Jun-18 | 7.00% (V) | 743 | – | 743 |
| P.R. (ULTRACOM) | Feb-23 | 3.25% (F) | 842 | 7,294 | 8,136 |
| | | | 755,665 | 7,294 | 762,959 |
| Notes payable, restricted: | | | | | |
| Revolving line of credit of $100 million to fund swap's collateral posting | | | 6,100 | – | 6,100 |
| Total notes payable | | | $ 761,765 | $ 7,294 | $ 769,059 |

(V) – *variable interest rate*

(F) – *fixed interest rate*

Short-term debt activity for the years ended June 30, 2014 and 2013 was as follows:

| | **2014** | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Balance at beginning of year | **$ 761,765** | $ 605,219 |
| Proceeds and transfers from long-term debt | **734,029** | 1,512,950 |
| Payment of short-term debt | **(761,886)** | (1,356,404) |
| Balance at end of year | **$ 733,908** | $ 761,765 |
| Notes payable – short-term: | | |
| Unrestricted | **$ 733,908** | $ 755,665 |
| Restricted | **–** | 6,100 |
| Total of notes payable | **$ 733,908** | $ 761,765 |

## 9. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities at June 30, 2014 and 2013 were as follows:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Accounts payable, accruals, and withholdings in process of payment | **$ 836,640** | $ 791,680 |
| Additional accruals and withholdings: | | |
| Injuries and damages and other | **5,305** | 20,400 |
| Accrued vacation and payroll benefits | **57,301** | 56,179 |
| Accrued sick leave and payroll benefits - exclusive of benefits to be liquidated after one year of approximately $114.5 million in 2014 and $122.4 million in 2013 | **30,628** | 31,576 |
| Accrued compensation | **9,484** | 26,432 |
| Accrued pension plan contribution and withholding from employees: | | |
| Employees' Retirement System | **19,096** | 18,054 |
| Employees health plan | **27,831** | 6,275 |
| Contribution in lieu of taxes | **572,385** | 323,622 |
| Other accrued liabilities | **27,720** | 26,810 |
| | **$1,586,390** | $ 1,301,028 |

## 10. Other Current Liabilities Payable from Restricted Assets

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Contract retainage | **$ 6,165** | $ 7,173 |
| Other liabilities | **54,449** | 32,421 |
| | **$ 60,614** | $ 39,594 |

## 11. Long-Term Debt

At June 30, 2014 and 2013, long-term debt consists of:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Power Revenue Bonds payable: | | |
| Publicly offered at various dates from 2002 to 2013, interest rates ranging from 2.5 to 7.25%, maturing to 2043 | **$8,526,710** | $8,048,485 |
| Plus unamortized premium/discount, net | **141,715** | 170,427 |
| Revenue bonds payable, net | **8,668,425** | 8,218,912 |
| Notes payable and bond anticipation notes | **744,770** | 769,059 |
| | **9,413,195** | 8,987,971 |
| Less current portion of long-term debt: | | |
| Notes payable from unrestricted assets | **733,908** | 755,665 |
| Notes payable from restricted assets | **–** | 6,100 |
| Power revenue bonds | **432,281** | 413,546 |
| Total current portion of long-term debt | **1,166,189** | 1,175,311 |
| | **$8,247,006** | $7,812,660 |

## 11. Long-Term Debt (continued)

Long-term debt activity for the years ended June 30, 2014 and 2013 was as follows:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Long-term debt excluding current portion at beginning of year | **$ 8,987,971** | $ 9,042,843 |
| New issues: | | |
| Power revenue bonds | **673,145** | – |
| Debt discount on new bond issues, net | **(14,806)** | – |
| Notes payable | **1,709,900** | 1,501,656 |
| | **11,356,210** | 10,544,499 |
| Payments: | | |
| Power revenue bond – July 1 | **(194,920)** | (185,605) |
| Notes payable | **(1,734,188)** | (1,356,411) |
| Total payments | **(1,929,108)** | (1,542,016) |
| Amortization of debt discount | **(13,907)** | (14,512) |
| Balance at end of year | **$ 9,413,195** | $ 8,987,971 |
| Current portion of notes payable | **$ 733,908** | $ 761,765 |
| Current portion of power revenue bonds | **432,281** | 413,546 |
| Total current portion of long-term debt | **$ 1,166,189** | $ 1,175,311 |

## 11. Long-Term Debt (continued)

### Power Revenue Bonds Payable

During fiscal year 2014, the Authority issued its Power Revenue Bonds, Series 2013A. A summary of the net proceeds of the Power Revenue Bonds, Series 2013A and the application of the proceeds follows (in thousands):

| | |
|---|---|
| Sources: | |
| Principal amount of the bonds | $ 673,145 |
| Net original issue discount | (10,502) |
| Total sources | $ 662,643 |
| | |
| Application of net proceeds: | |
| Deposit to 1974 Construction Fund | $ 500,000 |
| Deposit to 1974 Reserve Account | 46,439 |
| Payment of line of credit and accrued interest | 109,647 |
| Underwriting discount and estimated legal, printing and other financing expenses | 6,557 |
| Total application of proceeds | $ 662,643 |

Maturities of the Power Revenue Bonds Series 2013A, issued during fiscal year 2014 range July 1, 2030 to July 1, 2043. The Series 2013A bear fixed interest rates ranging from 6.75% to 7.25%. Interest on the Series 2013A is payable on the first day of each July and January.

The Authority has issued Power Revenue Bonds pursuant to the 1974 Agreement principally for the purpose of financing the cost of improvements; as such term is defined in the 1974 Agreement, and subject to the conditions and limitations set forth therein.

In the 1974 Agreement, the Authority covenants to fix, charge, and collect rates so that revenues will be sufficient to pay current expenses and to provide the greater of (i) the required deposits or transfers under the Sinking Fund, the 1974 Self-insurance Fund and the Reserve Maintenance Fund or (ii) 120% of the aggregate principal and interest requirements for the next fiscal year on account of all outstanding Power Revenue Bonds. See further discussion in Note 20.

## 11. Long-Term Debt (continued)

### Power Revenue Bonds Payable (continued)

Gross revenues, exclusive of income on certain investments, less current expenses as defined in the 1974 Agreement have been pledged to repay Power Revenue Bonds principal and interest.

### Bond Anticipation Notes

Bond anticipation notes (BANs) are used primarily to provide interim construction financing and are usually retired with the proceeds of long-term debt.

### Swap Agreements

To protect against the potential of rising interest rates, the Authority entered into quarterly separate pay-fixed, receive-variable interest-rate, basis and commodity swap agreements at a cost anticipated to be less than what the Authority would have paid to issue fixed-rate debt. On June 30, 2014, the Authority had the following derivative instruments outstanding (in thousands):

| Item | Type | Objective | Effective Date | Maturity Date | Terms | Counterparty Credit Rating | Notional Amount |
|---|---|---|---|---|---|---|---|
| A | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2029 | Pay 4.08%; receive 67% 3M LIBOR + 0.52% | Aa3/A+ | $ 169,532 |
| B | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2029 | Pay 4.08%; receive 67% 3M LIBOR + 0.52% | Aa3/A+ | 83,343 |
| | | | | | | | $ 252,875 |

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

On June 30, 2013, the Authority had the following derivative instruments outstanding (in thousands):

| Item | Type | Objective | Effective Date | Maturity Date | Terms | Counterparty Credit Rating | Notional Amount |
|---|---|---|---|---|---|---|---|
| A | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2017 | Pay 4.014%; receive 5Y SIFMA | Aa3/A+ | $ 25,525 |
| B | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2018 | Pay 4.054%; receive 5Y SIFMA | Aa3/A+ | 17,000 |
| C | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2020 | Pay 4.124%; receive 5Y SIFMA | Aa3/A+ | 29,055 |
| D | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2025 | Pay 4.232%; receive 67% 3M LIBOR + 0.68% | Aa3/A+ | 14,570 |
| E | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2029 | Pay 4.08%; receive 67% 3M LIBOR + 0.52% | Aa3/A+ | 169,532 |
| F | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2031 | Pay 4.286%; receive 67% 3M LIBOR + 0.70% | Aa3/A+ | 72,800 |
| G | Pay-Fixed Interest Rate Swap | Hedge of changes in cash flows on the Series UU Bonds | 5/3/2007 | 7/1/2029 | Pay 4.08%; receive 67% 3M LIBOR + 0.52% | A2/A | 83,343 |
| H | Basis Swap Goldman Sachs | Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual | 7/1/2008 | 7/1/2037 | Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669% | A2/A | 500,000 |
| I | Basis Swap Deutsche Bank | Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual | 5/10/2012 | 7/1/2037 | Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669% | A2/A | 200,000 |
| J | Basis Swap Royal Bank of Canada | Hedges tax risk on underlying fixed rate bonds (various) and provides expected positive cash flow accrual | 5/10/2012 | 7/1/2037 | Pay SIFMA; receive 62% 3M LIBOR + 0.29% + 0.4669% | Aa3/AA- | 300,000 |
| K | Commodity Swap JP Morgan | Hedge Fuel Cost | 10/1/2012 | 10/1/2013 | N.Y. Harbor No. 6 1% Cargo | Aa3/A+ | 1,675 |
| L | Commodity Swap Macquire Bank | Hedge Fuel Cost | 7/1/2012 | 7/1/2013 | N.Y. Harbor No. 6 1% Cargo | A2/A | 120 |
| M | Commodity Swap Morgan Stanley | Hedge Fuel Cost | 10/1/2012 | 10/1/2013 | N.Y. Harbor No. 6 1% Cargo | Baa2/A- | 225 |
| N | Commodity Swap Scotiabank | Hedge Fuel Cost | 7/1/2012 | 7/1/2013 | N.Y. Harbor No. 6 1% Cargo | Aa2/A+ | 175 |
| | | | | | | | $ 1,414,020 |

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

Derivative instruments A and B hedge changes in cash flows of the underlying bonds – floating rate notes with coupons based on 5-year SIFMA or 67% of 3-month LIBOR index, and maturities equal to the maturities of the corresponding swaps. As such they are considered hedging derivative instruments. The total fair value of these instruments as of June 30, 2014 is negative $48.9 million.

The following tables include summary information for the Authority's effective hedges related to the outstanding swap agreements for fiscal years 2014 and 2013.

| | Changes in Fair Value | | Fair Value at June 30, 2014 | | |
|---|---|---|---|---|---|
| **Instrument Type** | **Classification** | **Amount** | **Classification** | **Amount** | **Notional** |
| Interest Rate Swap | Deferred Outflows | **$ 22,106** | Fair value of derivative instruments | **$ (48,864)** | **$ 252,875** |
| Basis Swap | Investment income | **7,612** | Fair value of derivative instruments | – | – |
| Commodity Swap | Investment income | **6,422** | Fair value of derivative instruments | – | – |
| | Total | **$ 36,140** | | **$ (48,864)** | **$ 252,875** |

| | Changes in Fair Value | | Fair Value at June 30, 2013 | | |
|---|---|---|---|---|---|
| **Instrument Type** | **Classification** | **Amount** | **Classification** | **Amount** | **Notional** |
| Interest Rate Swap | Deferred Outflows | $ 37,468 | Fair value of derivative instruments | $ (70,970) | $ 411,825 |
| Basis Swap | Deferred Outflows | (4,743) | Fair value of derivative instruments | (7,612) | 1,000,000 |
| Commodity Swap | Deferred Outflows | (6,422) | Fair value of derivative instruments | (6,422) | 2,195 |
| | Total | $ 26,303 | | $ (85,004) | $ 1,414,020 |

As of June 30, 2014 and 2013, negative fair values of the derivative instruments are $48.9 million and $85.0 million, respectively.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Interest-Rate Swap Agreements*

The terms, fair values and credit ratings of the outstanding interest-rate swaps as of June 30, 2014 and 2013, were as follows (in thousands):

| Associated Power Revenue Bonds | 6/30/2014 | Effective Date | Maturity Date | Fixed Rate | Fair Value 2014 | Fair Value 2013 |
|---|---|---|---|---|---|---|
| Libor Bonds, Series UU | **$ 169,532** | 3-May-07 | 1-Jul-29 | 4.08% | **$ (32,835)** | $ (31,846) |
| Libor Bonds, Series UU | **83,343** | 3-May-07 | 1-Jul-29 | 4.08% | **(16,029)** | (15,621) |
| Libor Bonds, Series UU | **–** | 3-May-07 | 1-Jul-25 | 4.23% | **–** | (2,441) |
| Libor Bonds, Series UU | **–** | 3-May-07 | 1-Jul-31 | 4.29% | **–** | (14,529) |
| Muni-BMS Bonds, Series UU | **–** | 3-May-07 | 3-Jul-17 | 4.01% | **–** | (2,071) |
| Muni-BMS Bonds, Series UU | **–** | 3-May-07 | 2-Jul-18 | 4.05% | **–** | (1,523) |
| Muni-BMS Bonds, Series UU | **–** | 3-May-07 | 1-Jul-20 | 4.12% | **–** | (2,939) |
| Total | **$ 252,875** | | | | **$ (48,864)** | $ (70,970) |

The notional amounts of the swaps match the principal amounts of the associated Power Revenue Bonds.

During fiscal years 2014 and 2013, the payments of fixed rate interest from the Authority exceeded the amount received as variable interest rate from swap counterparties by $15.7 million and $16.9 million, respectively.

Using rates as of June 30, 2014, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term. These debt service requirements are included in the scheduled maturities of long-term debt disclosed further in this note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Interest-Rate Swap Agreements (continued)*

| Fiscal Year Ending June 30 | Principal | Interest | Interest-Rate Swap, Net | Total |
|---|---|---|---|---|
| | | *(In thousands)* | | |
| 2015 | $ – | $ 2,108 | $ 8,209 | $ 10,317 |
| 2016 | – | 2,108 | 8,209 | 10,317 |
| 2017 | – | 2,108 | 8,209 | 10,317 |
| 2018 | – | 2,108 | 8,209 | 10,317 |
| 2019 | – | 2,108 | 8,209 | 10,317 |
| 2020-2029 | 252,875 | 21,081 | 82,092 | 356,048 |
| Total | $ 252,875 | $ 31,621 | $ 123,137 | $ 407,633 |

On June 4, 2014, the Authority terminated $158.9 million in notional amounts with J.P. Morgan. Pursuant to the agreement the Authority paid $21.3 million in order to partially terminate the interest rate swap. As of June 30, 2014, the current outstanding notional amount of this swap is $252.9 million.

As of June 30, 2014 and 2013, the swaps had a negative fair value of approximately $48.9 million and $70.9 million, respectively. The negative fair value of the swaps may be countered by a reduction in future net interest payments required on the variable-rate Power Revenue Bonds, creating higher synthetic rates.

As of June 30, 2014 and 2013, the Authority was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Authority would be exposed to credit risk in the amount of the derivative's fair value. The swaps counterparties were rated A2 and Aa3 as issued by Moody's Investor Services (Moody's), AA- and A+ by Standard & Poors (S&P), and A and A+ by Fitch Ratings.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Interest-Rate Swap Agreements (continued)*

The derivative contract uses the International Swaps and Derivatives Association, Inc. Master Swap Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Authority or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contracts. Also, the swaps may be terminated by the Authority if the counterparties' credit quality rating falls below Baa1 as determined by Moody's or BBB+ as determined by S&P. If at the time of termination the swap has a negative fair value, the Authority would be liable to the counterparty for a payment equal to the swap's fair value.

*Basis Swap Agreement*

In March 2008 (with effective date of July 1, 2008), the Authority entered into a basis swap agreement in the notional amount of $1,375 million with an amortization schedule matching certain maturities of the Authority's outstanding power revenue and revenue refunding bonds issued in various years from 2027 to 2037 (the 2008 basis swap). Under the terms of the Master Swap Agreement, the Authority receives from its counterparty (Goldman Sachs Capital Markets, L.P., an affiliate of Goldman, Sachs & Co.) quarterly, commencing on October 1, 2008, a floating amount applied to said notional amount at a rate equal to 62% of the taxable London Inter-Bank Offering Rate (LIBOR) index reset each week plus 29 basis points (hundredths of a percent) and a fixed rate payment of 0.4669% per annum (the "basis annuity"), quarterly for the term of swap in return for quarterly payments by the Authority, commencing also on October 1, 2008, on such notional amount at a rate based on the Securities Industry and Financial Markets Association (SIFMA) municipal swap index.

During the last quarter of fiscal year 2014, the Authority terminated the basis swap with a $1.0 billion notional amount that was outstanding. As agreed upon, the Authority paid $16.5 million to the counter party in order to terminate the basis swap.

The basis swap hedges the portion of the fair value of the underlying liabilities attributable to the relative value/basis risk between tax-exempt and taxable rates. Because of the tax-exemption, tax-exempt bonds trade at yields lower than taxable yields. The percent at which tax-exempt yields trade relative to taxable yields (UST or LIBOR) is referred to as MMD ratios or muni-bond ratios.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Basis Swap Agreement (continued)*

In order to assess effectiveness of the basis swap as a hedge, the Authority ran a regression of SIFMA ratios (as an independent variable) and MMD ratios (as dependent variable), adjusting to the specific circumstances. The result showed a high correlation. The method used can be qualified as Other Quantitative Method.

Because the MMD ratios and SIFMA ratios reflected respectively the change in the relationship of tax-exempt rates to taxable rates in the bond market and the SIFMA swap market, the Authority concluded that the regression showed that the SIFMA swap could effectively hedge the basis risk between tax-exempt and taxable rates and, therefore, the basis swap was considered an effective hedge instrument under GASB 53.

By using derivative financial instruments to hedge the exposure to changes in interest rates, the Authority exposes itself to credit risk, market-access risk and basis risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Authority, which creates a credit risk for the Authority. When the fair value of the derivative contract is negative, the Authority owes to the counterparty and, therefore, does not pose credit risk to the Authority. The Authority minimizes the credit risk in derivative instruments by entering into transactions with high-quality counterparties whose credit rating is acceptable under the investment policies of the Authority and of GDB, its fiscal agent.

Market risk is the adverse effect on the value of a financial instrument that results from a change in interest rates. The market risk associated with an interest rate swap contract is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken. The Authority assesses market risk by continually identifying and monitoring changes in interest rate exposures that may adversely affect expected interest rate swap contract cash flows and evaluating other hedging opportunities. The Authority and GDB maintain risk management control systems to monitor interest rate cash flow risk attributable to both the Authority's outstanding or forecasted debt obligations as well as the Authority's offsetting hedge positions.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Basis Swap Agreement (continued)*

Basis risk arises when different indices are used in connection with a derivative instrument such as an interest rate swap contract. The 2008 basis swap exposes the Authority to basis risk should the relationship between LIBOR and the SIFMA municipal swap index converge. If a change occurs that results in the relationship moving to convergence, the expected financial benefits may not be realized. The Authority assesses basis risk by following the aforementioned market risks control system.

During fiscal years 2014 and 2013, the Authority received from its counterparty $4.7 million and $9.1 million, respectively. The following table shows the cash flow benefit of the basis annuity in exchange for the Authority taking tax and other basis risks tied to the change in the relationship between LIBOR and the SIFMA municipal swap index.

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Basis annuity received | **$ 1,167** | $ 2,510 |
| LIBOR index amounts received | **3,869** | 8,188 |
| SIFMA index amounts paid | **(300)** | (1,589) |
| Net amount received | **$ 4,736** | $ 9,109 |

According to the Credit Support Annex of the Master Swap Agreement, the Authority shall post eligible collateral on the next business day upon notification from its counterparty, if the fair value of the 2008 basis swap is negative and exceeds the threshold amount. This amount is determined by the Authority’s credit ratings with Moody’s Investors Service and Standard & Poor’s. Based on the Authority’s ratings, the collateral posting threshold is zero.

The Authority and GDB entered into an agreement for a $100 million revolving line of credit to meet collateral posting requirements from the 2008 basis and interest rate swaps. As of June 30, 2014, there was a $35.1 million outstanding balance in this line of credit. This balance is mainly related to the amounts paid under the termination agreements of the swap.

## 11. Long-Term Debt (continued)

### Swap Agreements (continued)

*Commodity Swap Agreement*

During fiscal year 2012, the Authority entered into a 2012 Commodity Swap Agreement that provided it with protection against increases in the price of fuel of oil No. 6 covering contracts for 10.2 million barrels from June 2012 through October 2013. The notional amount of the swaps matches the barrel of fuel.

The premium amount established for this swap was $29.2 million, which was amortized from June 2012 to October 2013.

The Authority paid to its counterparties $6.4 million and $21.9 million for fiscal years 2014 and 2013, respectively. This derivative instrument expired in October 2013, as a result it had no outstanding balance as of June 30, 2014, and a negative fair value of $6.4 million as of June 30, 2013.

## 11. Long-Term Debt (continued)

### Scheduled Maturities of Long-Term Debt

The scheduled maturities of long-term debt with interest thereon as of June 30, 2014, are as follows:

| Fiscal Year Ending June 30, | Principal | Interest | Total |
|---|---|---|---|
| 2015 | $ 1,152,623 | $ 426,505 | $ 1,579,128 |
| 2016 | 229,287 | 415,395 | 644,682 |
| 2017 | 238,207 | 403,730 | 641,937 |
| 2018 | 250,377 | 391,530 | 641,907 |
| 2019 | 262,355 | 378,923 | 641,278 |
| 2020-2024 | 1,525,286 | 1,682,360 | 3,207,646 |
| 2025-2029 | 1,895,140 | 1,268,457 | 3,163,597 |
| 2030-2034 | 1,458,545 | 829,573 | 2,288,118 |
| 2035-2039 | 1,381,460 | 446,711 | 1,828,171 |
| 2040-2043 | 878,200 | 107,127 | 985,327 |
| Total | 9,271,480 | 6,350,311 | 15,621,791 |
| Less: | | | |
| Unamortized premium/discount, net | 141,715 | – | 141,715 |
| Interest | – | (6,350,311) | (6,350,311) |
| Total long-term debt | 9,413,195 | – | 9,413,195 |
| | | | |
| Current portion, net of discount | (432,281) | – | (432,281) |
| Current portion of notes payable | (733,908) | – | (733,908) |
| Total current portion | (1,166,189) | – | (1,166,189) |
| Long-term debt, excluding current portion | $ 8,247,006 | $ – | $ 8,247,006 |

## 12. Employees' Retirement Benefits

### Pension Plan

Plan Description

All of the Authority's permanent full-time employees are eligible to participate in the Authority's Pension Plan, a single employer defined benefit pension plan (the Plan) administered by the Employees' Retirement System of the Puerto Rico Electric Power Authority (the System). The System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report may be obtained by writing to the Retirement System of the Puerto Rico Electric Power Authority, PO Box 13978, San Juan, Puerto Rico 00908-3978.

Benefits include maximum retirement benefits of 75% of average basic salary (based on the three highest annual basic salaries) for employees with 30 years of service; with reduced benefits available upon early retirement. The Plan was amended on February 9, 1993 to provide revised benefits to new employees limiting the maximum retirement basic salary to $50,000. The plan was further amended in January 1, 2000 to provide improved retirement benefits to employees with 25 years or more of credited service. Disability and death benefits are also provided. Separation benefits fully vest upon reaching 10 years of credited service.

If a member's employment is terminated before he becomes eligible for any other benefits under this Plan, he shall receive a refund of his member contribution plus interest compounded annually. The Plan is not subject to the requirements of the Employees Retirement Income Security Act of 1974 (ERISA).

Funding Policy and Annual Pension Cost

The contribution requirements of plan members and the Authority are established and may be amended by the Authority. The Annual Pension Cost (APC) and the Annual Required Contribution (ARC) were computed as part of an actuarial valuation performed as of June 30, 2013 and projected to June 30, 2014, based on current year demographic data.

## 12. Employees' Retirement Benefits (continued)

Funding Policy and Annual Pension Cost (continued)

The contribution requirements to the System of plan members and the Authority are established and may be amended by the Authority. The Authority's annual pension cost to the System for the fiscal years ended June 30, 2014 and 2013 is as follows:

| | Fiscal Year Ending June 30 | |
|---|---|---|
| | **2014** | **2013** |
| Annual required contribution | **$ 99,971,184** | $ 89,405,009 |
| Interest on net pension obligation | **1,276,170** | 1,249,465 |
| Adjustment to annual required contribution | **(972,705)** | (935,293) |
| Annual Pension Cost | **100,274,649** | 89,719,181 |
| Contributions made and accruals | **(99,971,184)** | (89,405,009) |
| Increase (decrease) on net pension obligation | **303,465** | 314,172 |
| Net pension obligation, beginning of year | **15,013,760** | 14,699,588 |
| Net pension obligation, end of year | **$ 15,317,225** | $ 15,013,760 |

## 12. Employees' Retirement Benefits (continued)

The Authority's annual pension cost for the year ended June 30, 2014 and related information for the Plan and supplemental benefits follows:

| | Pension Plan |
|---|---|
| Contribution rates: | |
| Authority | 29.29% |
| Average Plan members | 10.44% |
| Annual pension cost (thousands) | $100,275 |
| Contributions made and accruals (thousands) | $99,971 |
| Actuarial valuation date | 6/30/2012 |
| Actuarial cost method | Individual: Entry Age Normal |
| Amortization method | Level percentage of pay, closed (4% payroll increases per year) |
| Remaining amortization period | 28 years |
| Asset valuation method | 5-year smoothed market |
| Actuarial assumptions: | |
| Investment rate of return (net of administrative expenses)* | 8.5% |
| Projected salary increases* | 4.10% – 5.40% depending on age |
| *Includes inflation at | 3.0% |
| Cost-of-living adjustments | 8% per year for yearly pension up to $3,600 and 4% per year for yearly pension between $3,600 and $7,200, 2% per year for yearly pension in excess of $7,200. The minimum adjustment is $300 per year. The maximum is $600 per year. |

## 12. Employees' Retirement Benefits (continued)

### Supplemental Benefits not Funded Through the System

**Trend Information**
*(In millions)*

| Fiscal Year Ended | Annual Pension Cost (APC) | Percentage of APC Contributed | Net Pension Obligation |
|---|---|---|---|
| Pension Plan: | | | |
| 06/30/12 | 84.6 | 99.6% | 14.7 |
| 06/30/13 | 89.7 | 99.7% | 15.0 |
| 06/30/14 | 100.3 | 99.7% | 15.3 |

The annual required contribution amounted to $100.0 million and $89.4 million in 2014 and 2013, respectively. The net pension obligation is included in accounts payable and accrued liabilities in the Statements of Net Position.

Supplemental benefits were unfunded and such benefits were reimbursed to the System when paid as of December 31, 1999. Effective January 1, 2000, the Board of Trustees of the System approved the transfer of the obligation for supplemental benefits provided by the Authority and not funded through the System (supplemental pension obligations exchanged for forfeited sick leave benefits and the supplemental spousal survivor benefits) to the Retirement System. Also, the Board of Trustees of the System accepted an amortization period for the Plan of 40 years, which commenced on June 30, 1996.

## 12. Employees' Retirement Benefits (continued)

### Supplemental Benefits not Funded Through the System (continued)

Supplemental Pension Obligations Exchanged for Forfeited Sick Leave Benefits

The Authority's employees with over 20 years of service are entitled to exchange accrued sick leave for supplemental pension benefits just to complete merit annuity (30 years of service) and/or be paid in cash the value of such sick leave upon separation from employment.

### Other Post-Employment Benefits (OPEB)

Postemployment Health Plan

*Plan Description* – PREPA Retired Employees Healthcare Plan (Health Plan) is a single-employer defined benefit healthcare plan administered by the Authority. During fiscal year 2010, the Authority adopted a resolution to change the Health Plan. The Health Plan for all retirees will be capped at $300 per member per month for retirees and spouses under age 65 and $200 per member per month for retirees and spouses age 65 and over.

*Membership* – During fiscal year 2010, the Health Plan changed to require all new retired employees on or after September 1, 2009, to have 30 year of services to receive health benefits. Certain retired employees on or after September 1, 2009, all retired employees before September 1, 2009, are eligible to participate in the Postretirement Health Plan. To remain eligible for participation, Medicare eligible retired participants and their spouses must enroll in Medicare Part B at age 65, or whenever eligible, at their own expenses. The benefit provisions to retired employees are established and may be amended by the Authority.

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

*Funding Policy and Annual OPEB Cost* – The required contribution is based on projected pay-as-you-go financing requirements. The contribution requirements of plan members and the Authority are established and may be amended by the Authority.

The Annual OPEB Cost is calculated based on the Annual Required Contribution (ARC) of the employer, an amount actuarially determined in accordance with the provisions of GASB Statement No. 45. The ARC represents a level of funding that, if paid on ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The following table shows the components of the Authority's annual OPEB cost for fiscal years 2014 and 2013 (in thousands):

| | **2014** | **2013** |
|---|---|---|
| Annual OPEB cost | **$ 19,553** | $ 20,464 |
| Actuarial Accrued Liability (AAL) | **$378,444** | $408,419 |
| Unfunded AAL | **$378,444** | $408,419 |
| Funded Ratio | **0%** | 0% |
| Annual Covered Payroll | **$364,982** | $357,405 |

The net OPEB obligation change is as follows (in thousands):

| | **2014** | **2013** |
|---|---|---|
| Change in net OPEB obligation: | | |
| Net OPEB obligation, beginning balance | **$119,826** | $122,627 |
| Total annual required contribution (ARC), July 1–June 30 | **18,754** | 19,647 |
| Interest on Net OPEB obligation | **4,793** | 4,905 |
| Adjustments to annual required contribution | **(3,994)** | (4,088) |
| Actual benefit payments, July 1–June 30 | **(20,204)** | (23,265) |
| Net OPEB obligation, ending balance | **$119,175** | $119,826 |

For the fiscal years ended June 30, 2014 and 2013, the Authority's annual OPEB expense was $19.6 million and $20.5 million, respectively. This expense is included in Administrative and General Expenses.

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

The OPEB expense is not equal to the Annual Required Contribution, which is considered in operating expenses in the Authority's Statement of Revenues, Expenses and Changes in Net Position.

For the fiscal year ended June 30, 2014, the Authority's annual OPEB expense of $19.6 million, which is included in Administrative and General Expenses. The OPEB expense is considered in operating expenses in the Authority's Statement of Revenues, Expenses and Changes in Net Position. The payment to the health plan for retirees and their beneficiaries totaled $20.2 million for fiscal year 2014.

The Authority's annual OPEB cost, and the net OPEB obligation for 2014 and the two preceding years were as follows:

**Trend Information**
*(In millions)*

| **Fiscal Year Ended** | **Annual OPEB Cost** | **Percentage of Annual OPEB Cost Contributed** | **Net OPEB Obligation** |
|---|---|---|---|
| 06/30/12 | $ 20.5 | 75% | $ 122.6 |
| 06/30/13 | $ 20.5 | 113% | $ 119.8 |
| 06/30/14 | $ 19.6 | 103% | $ 119.2 |

**12. Employees' Retirement Benefits (continued)**

**Other Post-Employment Benefits (OPEB) (continued)**

Postemployment Health Plan (continued)

*OPEB Actuarial Valuation* – The Authority's other Post-Employment Benefits Program actuarial valuation was conducted by Cavanaugh Macdonald Consulting, LLC. Cavanaugh Macdonald Consulting, LLC is a member of the American Academy of Actuaries. The valuation was performed in accordance with GASB Statement No. 45 requirements.

Actuarial Methods and Assumptions:

| | |
|---|---|
| Actuarial Valuation Date | July 1, 2012 |
| Actuarial Cost Method | Projected Unit Credit |
| Amortization method | Level Percent of Pay, Open |
| Remaining Amortization Period | 30 years |
| Actuarial Assets Valuation Method | Market Value of Assets |
| Investment Rate of Return | 4% (includes inflation rate) |
| Inflation Rate: | 3% |
| Medical | Not applicable |
| Prescription drug | Not applicable |
| Dental | Not applicable |
| Projected Salary Increases | 4% |

The required schedule of funding progress included supplementary information (Schedule I) that presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

## 13. Revenues from Major Clients and Related Parties

Electric operating revenues from major clients and related parties are as follows:

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Governmental sector, principally instrumentalities, agencies and corporations of the Commonwealth of Puerto Rico | **$ 566,379** | $ 639,849 |
| Municipalities of the Commonwealth of Puerto Rico | **249,310** | 260,839 |
| | **$ 815,689** | $ 900,688 |

## 14. Net Position

As of June 30, 2014, the Authority is in a net deficit position. The Authority faces a number of business challenges that have been exacerbated by the Commonwealth's economic recession, the volatility in oil prices, and the fact that the Authority has not increased rates to its customers at sufficient levels to offset the effects of its rising costs. Its principal challenges, some of which are interrelated, are: (i) addressing the decline in electric energy sales; (ii) addressing the volatility of oil costs; (iii) addressing high customer electric power rates; (iv) reducing government accounts receivables; and (v) improving its liquidity. In June 2014, the Authority entered into discussions with its financial with its financial stockholders in an effort to stabilize the Authority's liquidity situation and address its financial position. See further discussion in Notes 19 and 20.

## 15. Contribution in Lieu of Taxes

| | 2014 | 2013 |
|---|---|---|
| | *(In thousands)* | |
| Municipalities | **$ 249,310** | $260,839 |
| Commonwealth: | | |
| Hotels | **8,685** | 8,869 |
| Fuel adjustment subsidy | **19,781** | 27,843 |
| | **$ 277,776** | $297,551 |

## 16. Commitments and Contingencies

### Environmental Matters

Facilities and operations of the Authority are subject to regulation under numerous Federal and Commonwealth environmental laws, including the Clean Air Act, Clean Water Act, Oil Pollution Act (OPA), Resource Conservation Recovery Act (RCRA), Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) and Underground Storage Tanks, among others.

In February 1992, the Environmental Protection Agency (EPA) conducted a multimedia inspection of the Authority's facilities and identified several alleged instances of non-compliance related to the Authority's air, water and oil spill prevention control and countermeasures compliance programs.

The Authority and the EPA negotiated to resolve the issues regarding the deficiencies observed during the inspection and to ensure future compliance with all applicable laws and regulations. As a result of the negotiations, the Authority and the EPA reached an agreement that resulted in a consent decree (the Consent Decree) approved by the United States federal court in March 1999. Under the terms and conditions of the Consent Decree, the Authority paid a civil penalty of $1.5 million, and implemented additional compliance measures amounting $4.5 million. In addition, the Consent Decree requires that the Authority improve and implement compliance programs and operations in order to assure compliance with environmental laws and regulations.

In 2004, the United States federal court approved a modification to the Consent Decree agreed by the Authority and the EPA under which the Authority reduced, in two steps, the sulfur content in the No. 6 fuel oil used in certain generating units of its Costa Sur and Aguirre power plants (to 0.75% or less by March 1, 2005 and to 0.5% or less by March 1, 2007), and used No. 6 fuel oil with sulfur content of not more than 0.5% through July 18, 2009 at its Palo Seco and San Juan power plants. Additionally, the Authority has completed a nitrogen oxide emissions reduction program and modified the optimal operating ranges for all its units under the Consent Decree. The Authority also paid a $300,000 civil fine and reserved $200,000 to fund certain supplemental environmental projects and programs under the Consent Decree.

**16. Commitments and Contingencies (continued)**

**Environmental Matters (continued)**

PREPA has audited several instances for compliance with the Consent Decree programs, and understands that a considerable number of them can be closed since their requirements have been completed. PREPA has formally requested to meet with EPA on August 20, 2010; February 25, 2011; May 23, 2012 and June 15, 2012 to begin the process conducive to the partial termination of certain provisions of the Consent Decree and its Modification. On July 22, 2014, representatives from PREPA, EPA and United States Department of Justice (DOJ) met to begin the discussion towards the termination of some of the programs. As a result, the EPA and the DOJ requested PREPA to submit information regarding PREPA's compliance with the Programs for their review and evaluation. On September 25, 2014, PREPA met again with EPA and DOJ representatives and submitted the information requested, along with a letter formally requesting the EPA to review and approve the termination of those programs/provisions of the Consent Decree and its Modification of 2004 presented, as well as begin the process toward jointly filing in the Court a stipulation for Partial Termination of such programs. To accomplish this goal, PREPA suggested appointing a task force composed of EPA and PREPA representatives to schedule and meet to address the details agreed upon with EPA. On May 27 and 28, 2015, PREPA, EPA and DOJ legal representatives met to begin discussions about PREPA's termination claims, as well as define any additional documentation requested to support and demonstrate PREPA's determination of compliance with the different programs obligations. Additional information has been exchanged between all parties, and a follow-up meeting was held on October 1, 2015. EPA, PREPA and DOJ representatives continue with the thorough evaluation and discussion process of the information submitted by PREPA.

Since September 2004, there has been no legal action in the United States federal court or any administrative proceeding against the Authority regarding the Consent Decree or its modification. The Consent Decree includes stipulated penalties for certain events of non-compliance. Non-compliance events must be disclosed to EPA in the corresponding report. Ordinarily, when a covered non-compliance event occurs, the Authority pays the stipulated penalty in advance in order to benefit from a 50% discount of the applicable stipulated penalty.

## 16. Commitments and Contingencies (continued)

### Environmental Matters (continued)

*Other Proceedings*

In 1997, as a result of an inspection carried out by the EPA and the Puerto Rico Environmental Quality Board (the EQB) at the Authority's Palo Seco power plant, the EPA issued an Administrative Order for the investigation and possible remediation of seven areas identified by the EPA at the Palo Seco power plant and the Palo Seco General Warehouse (Depot). The Administrative Order required the Authority to carry out a Remedial Investigation/Feasibility Study (RI/FS). The RI/FS required under the order was designed to: (1) determine the nature and extent of contamination and any threat to the public health, welfare or environmental caused by any release or threatened release of hazardous substances, pollutants, or contaminants at or from the site; and (2) determine and evaluate alternatives for the remediation or control of the release or threatened release of hazardous substances, pollutants, or contaminants at or from the site. The RI was completed and a final report was submitted to EPA for evaluation.

The information gathered under the RI reflected the presence of free product (Separate Phase Hydrocarbons) in several monitoring wells. The analysis of this product also reflected a low concentration of polychlorinated biphenyls (PCBs). PREPA and EPA entered into an Administrative Order on Consent (AOC) (CERCLA-02-2008-2022) requiring the Authority to complete a removal plan that consisted of determining if the underground water had been impacted by PCBs, the extent of the contamination and the implementation of a work plan for free product removal. Analytical data collected during this activity reflected that underground water had not been impacted by PCBs. Nevertheless, water/oil mix was found in seven monitoring wells (MWs). PCBs concentrations between 1.36-2.36 parts per million were detected in the oil found in 3 of the 7 MWs. Multiphase extraction (MPE) activities in the MWs where water/oil phases were found, has been performed on a weekly basis. After several MPE, this activity was discontinued under the USEPA's recommendations.

On April 19, 2012, PREPA submitted for EPA's review and approval the final report letter for the AOC. On August 13, 2012, EPA notified PREPA by certified mail, that the final report was reviewed and determined that the work required pursuant the AOC has been fully carried out in accordance with its terms. Also the letter indicated that the notification shall not affect any continuing obligation of respondents, including but not limited to the reimbursement of EPA response costs, as specified in the AOC.

## 16. Commitments and Contingencies (continued)

### Environmental Matters (continued)

*Other Proceedings (continued)*

Based on the findings of the RI, the Human Health Risk Assessment, the Screening Level Ecological Risk Assessment and the AOC, NO ACTION recommendation under CERCLA for the PREPA, The Palo Seco site is believed to be protective of human health and environment. The risk assessments indicate that the levels of residual contaminants present at the site fall within EPA's acceptable risk range. This non-action remedy complies with the federal and commonwealth requirements.

"Both Orders" with Both AOC's established a Reimbursement of Costs condition in which the Authority agreed to reimburse EPA for all costs incurred by EPA in connection to the site. The Authority has not been charged for these costs to date and therefore there is no amount recorded in the financial statements for these cost reimbursements.

In 2002, the Authority received a "Special Notice Concerning Remedial Investigation/Feasibility Study for Soil at the Vega Baja Solid Waste Disposal Superfund Site. The EPA has identified the Authority and six other entities as "potentially responsible parties", as defined in the CERCLA. In 2003, the Authority agreed to join the other potentially responsible parties in an Administrative Order on Consent (AOC) for an RI/FS, with the understanding that such agreement did not constitute an acceptance of responsibility. Under the AOC, the Authority committed up to $250,000 as its contribution to partially fund the RI/FS. At this time, RI/FS has been completed. The work proceeded in accordance with the schedule established by the Authority and the other designated potentially responsible parties. On July 2010, a proposed Plan was issued identifying the Preferred Alternative to address soil contamination at the Vega Baja Solid Waste Disposal Site. EPA held a public hearing on August 3, 2010 to discuss the alternatives to address soil contamination.

## 16. Commitments and Contingencies (continued)

### Environmental Matters (continued)

*Other Proceedings (continued)*

The Record of Decision (ROD) was published as scheduled by EPA on September 30, 2011. Alternative No. 2, Removal with On-Site Consolidation and Cover in the Non-Residential Area, was selected. From this point on, EPA resumed negotiations with the Potential Responsible Parties (PRP's), both private and public, towards signing a Consent Decree through which the PRP's would contribute enough funds to cover the costs of the remedial action and the maintenance of the site. PREPA has already approved a contribution of $1,000,000 through Resolution 3804, April 1, 2011. Notwithstanding, through further negotiations an additional contribution of $300,000 was required by EPA. This additional contribution was approved by PREPA's Governing Board.

On December 4, 2012, the Federal Department of Justice lodged with the Court the Consent Decree (CD) Civil Action No. 3:12-cv-01988, which requires that PREPA shall pay to EPA for the Past Response Costs of the agency the amounts of $300,000 within 30 days of the effective date; $300,000 not later than August 15, 2013 and $300,000 not later than August 15, 2014.

In accordance with the definition of "effective date" in the CD, is the day the decree is entered on the court's docket controls. The Federal Court signed the CD on April 19, 2013 and entered the CD on the Docket on April 25, 2013. PREPA has complied with the Past Response Cost payment provided in the CD. To this date, PREPA has fulfilled all the Payments obligations in relation to this requirement.

On April 10, 2013, an Environmental Escrow Agreement (EEA) was entered into by and among the Government Development Bank for the Puerto Rico, as the escrow agent, the Puerto Rico Land Authority, the Puerto Rico Housing Department and PREPA; and the United States of America on behalf of the Environmental Protection Agency. This agreement became effective on April 25, 2013. The EEA (Account No. 251-0395-2) was created to serve as financial assurance for the performance of the obligation under the CD. On June 24, 2013, PREPA deposited $400,000 into the escrow as provided in the CD.

## 16. Commitments and Contingencies (continued)

### Environmental Matters (continued)

*Other Proceedings (continued)*

As agreed by the parties, this CD can be terminated upon motion by any party, provided that all public Defendants have satisfied their obligations of payments of Response Cost and Stipulated Penalties. Termination of this Consent Decree shall not affect the Covenants Not to Sue (Sections XX and XXI of the CD) including all reservations pertaining to those covenants and shall not affect any continuing obligation of the Settling Defendants under sections IX, X, XVI, XXIII and XXIV of the CD.

### Compliance Programs

The Authority continues to develop and implement a comprehensive program to improve environmental compliance in all applicable environmental media. This program has been and continues to be updated to conform to new regulatory requirements.

*Air Quality Compliance*

The Authority is consistently maintaining a 99% or better level of compliance with in stack opacity requirements. The Authority continues to use No. 6 fuel oil with sulfur content of 0.5% or better in its San Juan, Palo Seco and Aguirre Power Plants. In the case of the South Coast power plant, Units 5 and 6 have been converted to use natural gas, and are currently operating on a dual-fuel scenario. Units 3 and 4 operate minimally, and use Bunker C as fuel oil.

*Mercury and Air Toxics Standards*

The Mercury and Air Toxics Standard (MATS) was published by the Environmental Protection Agency (EPA), pursuant to Section 112 of the Clean Air Act (CAA), to establish national emission standards for hazardous air pollutants (NESHAP) limits and work practice standards for pollutants emitted from coal and oil fired electric utility steam generating units (EGU). It became effective on April 16, 2012, sixty days after it was published as a Final Rule in the Federal Register, Vol. 77, No. 32 on February 16, 2012.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Mercury and Air Toxics Standards (continued)*

The requirements established by the MATS are found in the Code of Federal Regulations, Title 40, Part 63, Subpart UUUUU, National Emission Standards for Hazardous Air Pollutants from Coal and Oil Fired Electric Utility Steam Generating Units. The terms and definitions used in this regulation are included in 40 CFR 63.10042, Subpart UUUUU.

The MATS applies to new, reconstructed or existing coal- and oil-fired EGUs in continental and non- continental areas (from industry, federal government, state and tribal government). In the case of Puerto Rico, there are fourteen (14) oil-fired EGUs affected by the regulation, which are operated and maintained by the PREPA, and two (2) coal-fired EGUs which are operated and maintained by AES-Puerto Rico, LLP.

The new rule requires that the affected units comply with the new standard requirements by April 16, 2015. According to MATS, owners/operators of units that cannot comply by the initial compliance date of April 16, 2015 can request an additional year (1st year) from the local environmental regulatory agency. In Puerto Rico, according with section 112(i)(3), of the CAA, the EQB has the delegated authority to approve such extension. Owners and operators can also request a second year (2nd year) extension to the EPA for those units that are determined to be critical to the reliability of the electrical system. This is based on the EPA's Enforcement Policy for Use of Clean Air Act Section 113(a) Administrative Orders in Relation to Electric Reliability and the Mercury and Air Toxics Standard of December 16, 2011. In order to obtain the second year extension, an early notice of compliance plans must be filed with the local Planning Authority (The Puerto Rico Planning Board) by April 16, 2013, a year after the effective date of the rule.

**16. Commitments and Contingencies (continued)**

**Compliance Programs (continued)**

*MATS Compliance Strategy*

Pursuant to Section 112(1)(3) of the Clean Air Act, PREPA initiated the process for requesting an Administrative Order for some of the EGUs affected by the MATS and to obtain from the EPA a 2nd year extension to the MATS initial compliance date for such units determined to be critical for the reliability of Puerto Rico's electrical system. On April 16, 2013, PREPA submitted an Early Notice of Compliance Plan to the Puerto Rico Planning Board. On May 14, 2013, the Governor of Puerto Rico issued an Executive Order (No. 2013-040) to create an Electrical Reliability Council, whose main goal is to evaluate the impact of the MATS implementation strategies and the integration of renewable energy source projects on the Puerto Rico's electrical system's operation and reliability. The Council creation became necessary because Puerto Rico is not subject to NERC or FERC jurisdiction. This Council would also serve as the Technical Advisor to the Puerto Rico Planning Board regarding PREPA's claim of the critical reliability impact of the EGUs included in the Early Notice of Compliance Plan.

PREPA has developed and commenced the implementation of this compliance plan for the new MATS emission limit requirements, as well as to address compliance with future air compliance regulations. Continuous compliance of some of the existing applicable units with MATS and future air compliance regulations requires the construction and development of a natural gas supply infrastructure in the Island of Puerto Rico. Unlike the Continental United States, this infrastructure is currently extremely limited to one port in the south side of the Island with no transmission and distribution pipelines. If natural gas is to be a viable option, infrastructure needs to be developed to supply some of PREPA's existing EGUs and any new future generation units. The development and construction of such infrastructure will result in the delay of the installation of controls (conversion projects) at some of the selected PREPA's existing EGUs, some of which require the EQB to grant a 1st year extension of the MATS initial compliance date of April 16, 2015. Such delays also affect other existing EGUs that are critical to the Puerto Rico's isolated electrical grid reliability.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*MATS Compliance Strategy (continued)*

In the case of Costa Sur Units 5 and 6, the EGUs were converted to have the capacity to use natural gas and bunker C in a dual -fuel scenario 2011. Under MATS classification, they have been designated as Non-Continental Liquid Oil-Fired EGUs. The infrastructure to supply natural gas to these EGUs is located in the EcoEléctrica's Liquefied Natural Gas terminal located in Peñuelas. Units 3 and 4 will be designated as Limited-Use Liquid Oil-Fired EGUs, which entails limiting each unit's operation to less than 8% in a 24 months block period of their respective nameplate heat input capacity, effective on April 16, 2015.

For the Aguirre Power Complex Units 1 and 2, they will be designated as Natural Gas-Fired EGUs upon completion of their respective conversion projects to provide them with the capacity to use natural gas as the primary fuel. Under this category, these EGUs will not be subject to MATS. To supply natural gas to the units, PREPA is committed to contract the development of the AOGP with Excelerate Energy, LLC, which is the contractor chosen to develop, construct and operate this gas port. The gas port will be located approximately 3 miles offshore the Jobos Bay in the municipality of Salinas, within the southern shore of the Commonwealth of Puerto Rico's territorial waters. The floating LNG terminal comprises an LNG transfer platform, a floating storage and regasification unit (FSRU), and a 4.1 mile long submarine natural gas pipeline. LNG will be received through LNG carriers that will dock in the terminal's platform. This project is currently in the process of obtaining the required regulatory certifications, endorsements, approvals, and permits from the agencies with jurisdiction (EQB, FERC and OGPe, among others) prior to commencing its construction. The AOGP construction is expected to end after the MATS initial compliance date, for which PREPA requested the EQB for a one year extension from the initial compliance date. Such extension was granted by EQB on March 28, 2014, allowing PREPA until April 16, 2016 to complete the conversion projects and demonstrate compliance with MATS.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*MATS Compliance Strategy (continued)*

On the Early Notice of Compliance Plan presented to the Puerto Rico Planning Board and EPA, PREPA presented the conversion of the San Juan Units 9 and 10 and Palo Seco Units 3 and 4 as the compliance strategy to follow. As explained before, the key condition for achieving this goal is the existence of a feasible natural gas managing infrastructure in the north coast of the Island to supply these EGUs. Following the Plan, in July 2013, PREPA began the process of requesting information from different natural gas companies and suppliers. Over thirty (30) companies provided presentations and information to PREPA regarding different proposals and alternatives to satisfy the project requirements. On August 2013, PREPA initiated a process with the Puerto Rico Public-Private Partnerships Authority (PPPA) process for the determination of the best technology and cost-effective alternative for the project, as well as the selection of the proposal and company that best fits such determination. On November 2013, the PPPA and PREPA selected KMPG as the financial advisor company that will be responsible for the evaluation of the financial investment alternatives, generation of the required request for proposals (RFP’s) and the final selection of the companies that comply with the established requirements. Galway Group, LP was also selected as technical advisor for the project. They will be responsible for the generation of a Desirability and Convenience Study, the first draft report for this study was submitted in June 2015.

Also, PREPA contracted Siemens Power Technologies International to perform a feasibility study to determine the impacts on the security of PREPA’s electrical system upon the possible suspension of power generation from Aguirre Units 1 and 2, San Juan Units 9 and 10, and Palo Seco Units 3 and 4 these units due the application of the Mercury and Air Toxic Standards (MATS). The study was concluded and the results presented to PREPA on September 12, 2014. The study concluded that these units are considered critical to maintain the Puerto Rico’s electrical system reliability.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*MATS Compliance Strategy (continued)*

Another factor that has affected the Plan's implementation for these units is that PREPA is currently under the Forbearance Agreement with its creditors. Such agreement requires to Alix Partners, acting as Chief Restructuring Officer, to develop a Business Plan, which includes the development of an Integrated Resource Plan (IRP). The first phase of the IRP was completed and presented to PREPA on November 13, 2014. The alternatives presented by the study consider the replacement of these units by new and more efficient technologies, such as high efficiency combined cycles. In March 2015, PREPA contracted Siemens to complete the second phase of the IRP, which is currently underway and is expected to be completed before by June 2015.

On December 3, 2014, PREPA requested the EQB a one-year extension to the MATS initial compliance date for each of these EGUs. The EQB requested PREPA additional information, which could not be supplied in the time provided since compliance alternatives implementation schedules are subject to the completion of the second phase of the IRP and the restructuring process results. In the case that compliance with MATS cannot be achieved for these units in the time allowed, including the extensions granted, PREPA considers reaching a settlement agreement with EPA to agree on a Consent Decree (or modify the existing one) to cover the period required to convert the existing EGUs to natural gas or replace them by a new and more efficient technology, and comply with the MATS requirements.

For the rest of the applicable EGUs (San Juan Units 7 and 8, and Palo Seco Units 3 and 4), they will be designated as Limited -Use Liquid Oil-Fired EGUs, which entails limiting each unit's operation to less than 8% in a 24 months block period of their respective nameplate heat input capacity, effective on April 16, 2015.

*QA/QC Continuous Monitoring Program*

This program requires quarterly audits to the opacity monitors in PREPA's power plants to insure compliance with the Consent Decree Clean Air Compliance Program. Also, this program requires annual quality assurance audits to the optimization monitors at our power plants in compliance with the Consent Decree. All these reports have been performed and submitted in compliance with the Consent Decree stipulations.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Relative Accuracy Test Audit (RATA)*

A Relative Accuracy Test Audit (RATA) is a test to validate and certify for a period of one year the plant's Continuous Emission Monitoring Systems (CEMS) equipment for purposes of continuous data collection. The requirements to perform this test are found at 40 CFR Part 60 Appendix F and is to insure compliance with the Plants PDS air operation permits. Annually reports have been performed and submitted in compliance with the air operation permits requirements. The Authority was not able to perform the RATA test for 2012 for Unit 3 at Cambalache Power Plant, due to operational problems with the plant. These tests were performed during February 2013.

*Title V Permitting Program*

PREPA is still awaiting issuance of a Title V Permit for the Palo Seco Power Plant. The permit application was submitted in November 1996. The Environmental Quality Board continues to request additional information. The last information request was received on January 27, 2012. The information requested was submitted on February 7, 2013. No other information has been requested. The EQB has not issued a final permit.

PREPA is also awaiting issuance of a Title V for the San Juan Power Plant. A modification was submitted to include the natural gas scenario for units 5 and 6. EQB has not issued a final permit, but issued a permit shield on November 2, 2009.

In September 2011, PREPA submitted a modification of the Costa Sur Power Plant's Title V permit to include the natural gas scenario for units 5 and 6. The EQB has not issued a final Title V permit.

The Title V permit for the Aguirre Power Complex expired on February 24, 2013. A permit renewal application was submitted in February 24, 2012. The Environmental Quality Board deemed the application as complete and, on June 12, 2012 issued a permit shield.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Title V Permitting Program (continued)*

PREPA had a scheduled meeting with the EQB (April 18, 2013) to discuss, among other things, the status of the Title V permits. Our goal is to have EQB issue all the permits in draft form to allow a comment period from PREPA. After this, the comments are either incorporated in the permit or rejected. Then, a final permit can be issued.

*Water Quality Compliance*

As of December 2010, the Authority had achieved and has maintained a level of compliance with the Clean Water Act regulations (NPDES permits, Safe Drinking Water Act, OPA'90 (FRP's and Operations Manual) and SPCC Regulation) in excess of 99%.

The Authority has completed compliance plans for abating water pollution at its four major power plants - Aguirre, San Juan, South Coast, and Palo Seco, as required by the Consent Decree, Section VI, Part I.

PREPA prepared and submitted the San Juan Power Plant NDPES Renewal Application on September 30, 2011. In compliance with the regulatory requirement, PREPA submitted it 180 days before the current NDPES Permit expiration date (March 31, 2012). The current NPDES Permit is administratively extended until the EPA grants a renewed permit.

PREPA uses drinking water from the Puerto Rico Aqueducts and Sewer Authority (PRASA) as raw water in order to generate electricity at the San Juan Power Plant. In 1994, Puerto Rico experienced a prolonged drought that forced PRASA to implement a water rationing plan, which limited the operation of the San Juan generating units. In addition, this power plant has exceedances related to the NPDES Discharge Permit (National Pollutants Discharge Elimination System) PR0000698. Specifically, with Outfalls 002 and 003 permit limit exceedances. The issuance of a new NPDES permit for SJPP in 2007 and a Water Quality Standards Regulation revision from the EQB in 2003 imposed more restrictive permit limits, which eventually led to the issuance of an Administrative Order (AO) CWA-02-2010-3119 by the EPA. As a control measure, PREPA began the process of developing and implementing the San Juan Waste Water Treatment Plant Improvement project (PREQB Project No. C-72-096-40) to reuse the Outfalls 002 and 003 process wastewater leaving these discharges as stormwater only.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Water Quality Compliance (continued)*

In December 2015, PREPA expects to complete the Phase I of the San Juan Waste Water Treatment Plant Improvement Project. This phase consists of the reuse of the generating units feedwater heaters condensations. Phase IV that consists of the acquisition and installation of Microfiltration and Reverse Osmosis Systems is in a pre-bid process.

PREPA's power generation, especially steam power plants, requires the high volumes of water. In the case of the Aguirre Power Complex (APC), this water comes from a water well system owned and operated by PREPA. These water wells supply capacity has been reduced throughout the years due to urban expansion in the Salinas Municipality, causing salt water intrusion to the aquifer. Considering this, PREPA determined to develop and construct the necessary infrastructure to supply raw water from the Patillas Irrigation Channel to the APC, keeping the current well water supply as back-up. The raw water will then be treated in the APC using ultrafiltration or microfiltration, reverse osmosis and demineralization methods. Also, the project provides for the reuse of condenser cooling water that is currently discharged thru the APC Outfalls, under the National Pollutant Discharge Elimination System Permit Program (NPDES Permit Program) required by Title 40 of the Code of Federal Regulations, Part 122. PREPA already completed the Phase II (Filtration System Building) in March 2015 of the Water Supply Project from the Patillas Irrigation Channel. Phase III (Retention Ponds Construction) of this project is in the bid adjudication process and Phase I (Pipeline Construction from the Irrigation Channel) is in a pre-bid process.

For the financing of the San Juan Waste Water Treatment Plant Improvement (C-72-096 -40) and the Water Supply Project from Patillas Lake Irrigation Channel Projects (C-72-128- 19), PREPA signed two Loan Agreements at 2% interest rate, pursuant to the Commonwealth of Puerto Rico Water Pollution Control State Revolving Fund Program (SRF Program). The first one was signed on September 6, 2012 for the amount of $17,560,028 and the second one on September 27, 2013 for the amount of $9,463,258.00. The September 27, 2013 agreement included a Grant for the amount of $1,536,742. These projects were not included in the PREPA's Capital Improvement Plan.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Water Quality Compliance (continued)*

Since 1977, PREPA submitted to EPA an updated request under Section 316(a) of the Clean Water Act that its South Coast power plant be permitted to discharge into the Caribbean Sea heated sea water that was previously used for cooling purposes, as part of the plant's combustion and generation process, known as "thermal effluent". EPA denied a 316(a) Thermal Variance Request in December 2000. After several discussions and meetings, EPA and PREPA agreed to perform a Detailed Engineering and Environmental Review (DEER) of alternatives to select a final alternative for the cooling water discharge that meets the water temperature standard or otherwise, qualify for a waiver request under Section 316(a) of the Water Quality Act. While the DEER was in progress EPA issued a draft permit for the power plant, which included a compliance schedule for the DEER selected alternative (Offshore Submerged Discharge – OSD). The selected alternative estimated capital cost is approximately $60 million. EPA issued a final permit in October 1, 2009 with a schedule of compliance for relocation of Outfall 001. PREPA submitted the scoping document, an inventory of the environmental studies already performed and a Joint Permit Application for the Outfall 001 relocation in December 2009. As part of the permit requirements, PREPA prepared a Preliminary Environmental Impact Statement (PEIS) including the discussions of four alternatives for the 001 Outfall by October 2011. The PEIS included an in-cove alternative to reduce the cooling water discharge temperature to a thermal tolerance temperature range based on operations improvements and partial restoration of the historic flow. On January 30, 2013, PREPA submitted a Final Environmental Impact Statement (FEA) at the Puerto Rico Management Permits Office (OGPe) including the in-cove alternative, as the preferred one.

PREPA prepared and submitted the South Coast Power Plant NDPES Renewal Application on March 30, 2014. In compliance with the regulatory requirement, PREPA submitted the application 180 days before the current NDPES Permit expiration date (September 30, 2014). The current NPDES Permit is administratively extended until the EPA grants a renewed permit. As part of the NPDES permit renewal, PREPA included OGPe's determination that the in-cove is the less environmental impact activity according to Section 4(b)(3) of the Environmental Public Policy Act [Act 416 – 2004].

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Water Quality Compliance (continued)*

EPA included, as part of Section 316(a) requirements in the current San Juan Power Plant NPDES Permit, the performance of thermal plume studies and the biological monitoring program. PREPA submitted the thermal plume study plan and the QA/QC Plan for the Biological Monitoring Program in March 13, 2009, and it is waiting for EPA approvals. Also, EPA included, as another compliance requirement, the performance of a Comprehensive Demonstration Study (CDS) under the Section 316(b) of the Clean Water Act. On March 31, 2008, PREPA submitted an Impingement and Entrainment Characterization Study and Current Status Report for EPA evaluation. Also, PREPA submitted a Post-repowering Verification Study Work Plan for 316(b) in June 30, 2008 and it is waiting for EPA approval. PREPA made a reference of all the above mentioned pending work plans approvals and 316(b) reports at the San Juan Power Plant NDPES Renewal Application submitted to EPA on September 30, 2011. EPA has not responded to this petition yet.

*Proposed Regulation under the CWA*

Pursuant to a consent decree with environmental organizations, the EPA has issued past rulemaking under Section 316(b) of the CWA in three phases. Existing large electric-generating facilities were addressed in Phase II of the rulemaking which was finalized in February 2004, while the existing small electric-generating and all manufacturing facilities were addressed in Phase III of the rulemaking, which was finalized in June 2006. However, the Phase II rulemaking and a portion of the Phase III rulemaking were subject to legal challenges and, therefore, remanded to EPA for reconsideration. As a result, on April 20, 2011, EPA published a new draft rule pertaining to Section 316(b) of the CWA. Compliance with this rule is established in reference to the date of issuance of the final rule. According to the terms of a settlement agreement with Riverkeeper, EPA was required to issue the final rule by July 27, 2012. The final rule was not issued by EPA at the proposed date, but instead signed an agreement with Riverkeeper (the “Third Amendment”) to finish the rule by November 4, 2013. EPA issued the 316 (b) Final Rule on November 12, 2014.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*<u>Proposed Regulation under the CWA (continued)</u>*

This new regulation has three (3) components. First, existing facilities that withdraw at least 25 percent of their water from an adjacent water body, exclusively for cooling purposes, and have a design intake flow of greater than 2 million gallons per day would be subject to an upper limit on the amount of fish allowed to be affected by impingement. To comply with this requirement, each facility is given the option of selecting the technologies that would be best suited to address it or reduce its intake velocity to 0.5 feet per second. Second, existing facilities that withdraw very large amounts of water, at least 125 million gallons per day, would be required to conduct studies to help their permitting authority determine whether and what site-specific controls, if any, would be required to reduce the number of aquatic organisms sucked into cooling water systems, known as entrainment. Third, new units that add electrical generation capacity at an existing facility would be required to add technology that is equivalent to closed-cycle cooling which may be achieved by incorporating a closed-cycle system into the design of the new unit or making other design changes with equivalent results.

PREPA has developed and is in the process of implementing an impingement and entrainment control technology (Aquatic Filter Barrier) in its South Coast Power Plant. This technology includes the verification sampling for impingement and entrainment. On June1, 2011, PREPA prepared and submitted to EPA a Plan of Action ("POA") for the South Coast Power Plant. The POA recommends the steps required to achieve the impingement and entrainment reduction. Based on these steps, PREPA understands that it will be able to comply with the existing NPDES permit conditions. In January 2015, PREPA finished the installation of an Aquatic Barrier at Units 5 and 6 Intake Structure, according with the compliance alternatives included in the EPA's POA. Also, PREPA received an Hydrolox Traveling Screen in March 2015, to be install in the Unit 5 Intake Area. PREPA received a proposal from his consultant for the verification sampling for impingement and entrainment at Guayanilla Bay.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Underground Injection Control Regulation*

PREPA has prepared a compliance plan to comply with the EQB's underground injection control regulations. This plan entails the closing of certain septic systems where sanitary discharges can be connected to the Puerto Rico Aqueduct and Sewer Authority (PRASA) system. As of December 2014, the projects at San Juan, Aguirre, Palo Seco, and South Coast Power Plants for the connection of the sanitary discharges to the PRASA system have been completed. PREPA completed the sampling and analysis of the septic systems at Aguirre, Palo Seco and San Juan. Currently, EQB's has not issued their evaluation in order to close the underground injection systems at Aguirre, Palo Seco and San Juan Power Plants.

*Spill Prevention Control and Countermeasures Plan (SPCCP)*

Under Section 311 of the CWA, EPA has issued regulations setting forth requirements for prevention of, preparedness for, and response to oil discharges at specific non-transportation-related facilities. To prevent oil from reaching navigable waters and adjoining shorelines, and to contain discharges of oil, the regulation requires these facilities to develop and implement SPCC Plans, and establishes procedures, methods and equipment requirements.

Pursuant to the terms of the Consent Decree, PREPA was required to implement a Spill Prevention Maintenance and Construction Program (SPMCP). This program included major overhauls to dikes and fuel tanks. As of December 2009, the Authority completed all compliance projects under the SPMCP of the Consent Decree, in accordance with the established scope of work.

PREPA has a program to comply with new SPCC requirements, which became effective on November 10, 2011. These requirements addressed the containment of potential leakages from oil containing electrical equipment in its distribution substations. PREPA has already implemented the monitoring and inspection requirements under these new regulations (40 C.F.R. §112.7(k)). Notwithstanding, during fiscal year 2011, PREPA completed the installation of spill response material at all its substations. In addition, it completed the construction of secondary containment at 36 of the 54 substations that are located besides water bodies. PREPA has budgeted $1.5 million for the completion of this program.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Spill Prevention Control and Countermeasures Plan (SPCCP) (continued)*

During 2015, PREPA updated the SPCC plans for EPA's Five Year Review for Aguirre, San Juan, Palo Seco, Costa Sur, Cambalache and Mayaguez. Also, PREPA updated the SPCC plans for the substations and Transmission and Distribution offices.

*Facility Response Plans (FRPs)*

Some facilities are also required to implement Facility Response Plans (FRP), depending on the fuel storage capacity and risk of harm to navigable waters and extent of risk they present with respect to an oil spill to a body of water. PREPA prepared and submitted the Five Year review FRP's for Aguirre Power Complex, San Juan Power Plant, Cambalache Turbine Gas Station, Mayaguez Turbine Gas Station and Palo Seco Power Plant to the United Sates Coast Guard for approval.

*Operation Manual*

Other PREPA's facilities are required, by the federal law, to have an Operation Manual implemented for the all the oil transfers operations. The Operation Manuals for San Juan and Palo Seco Power Plants, Aguirre Power Complex and Cambalache and Mayaguez Turbine Gas Stations has been amended and approved by the United States Coast Guard.

*PCB Program*

The Authority completed on 2000, a ten-year EPA-mandated program to sample and test its oil-filled transformers and other equipment in order to identify and dispose of PCB equipment. Pursuant to this program, the Authority has completed the removal and disposal of transformers with PCB concentrations of more than 500 ppm. The Authority continues with the removal and disposal of transformers with PCB concentrations between 50 and 499 ppm. According to EPA, the Authority has been the only utility to go so far with a program sample, test, identify, remove, and dispose of PCB or PCB contaminated transformers.

## 16. Commitments and Contingencies (continued)

### Compliance Programs (continued)

*Capital Improvement Program*

The Authority's capital improvement program for fiscal year that ended June 30, 2014 includes $10.5 million in order to comply with existing Commonwealth and federal environmental laws and regulations, including the South Coast water related projects in compliance with the Clean Water Act 316(a) and 316(b) sections previously discussed. The Authority keeps taking all the necessary steps to comply with all applicable environmental laws, regulations, and the Consent Decrees requirements.

*Self-Insurance Health Program*

Changes in the balances of the health insurance program (self-insurance risk) incurred but not recorded (IBNR) during fiscal years 2014 and 2013 were as follows:

| | Liability Beginning Balance | Expenses | Payments | Liability Ending Balance |
|---|---|---|---|---|
| | | *(In thousands)* | | |
| **2014** | **$5,270** | **$ 89,332** | **$ 88,870** | **$5,732** |
| 2013 | $7,188 | $ 100,889 | $ 102,807 | $5,270 |

These amounts are included in accounts payable and accrued liabilities in the statement of net position

**16. Commitments and Contingencies (continued)**

**Contingencies**

*General*

The Authority is a defendant or codefendant in numerous legal proceedings pertaining to matters incidental to its business and typical for an electrical utility of its size and nature, including claims for damages due to electrified wires, failure to supply power and fluctuations in the power supply. Pursuant to the Act, the Authority is authorized to sue and be sued by individuals or legal entities.

Under certain circumstances, as provided in Act No. 9 of November 26, 1975, as amended (Act No. 9), the Commonwealth may provide its officers and employees, including directors, executive directors and employees of public corporations and government instrumentalities and mayors of the municipalities of the Commonwealth, with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the amount of the judgment that may be paid under the provisions of Act No. 9 in cases before federal court, but in all other cases the Secretary of Justice of the Commonwealth may determine whether, and to what extent, the Commonwealth will assume payment of such judgment. Although the Authority's directors, executive director and employees are covered by the provisions of Act No. 9, Article 19 of Act No. 9 requires the Authority to cover the costs associated with judgments, expenses and attorneys' fees incurred by the Commonwealth in the legal representation of its directors, executive director and employees. To the extent the Authority is unable to cover these costs and expenses, the Authority would be required to reimburse the Commonwealth from future revenues, as provided by the Secretary of the Treasury of the Commonwealth in consultation with the Authority's board of directors.

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Abengoa Litigation*

In May 2000, Abengoa, Puerto Rico, S.E., the Authority's original contractor for the construction of the new generating units (Units 5 and 6) at the San Juan power plant, unilaterally declared a termination of the contract and filed a complaint for breach of contract. The Authority filed a counterclaim for breach of contract and for all damages caused to the Authority by the contract termination. On September 21, 2007, the Regional Administrating Judge for the Superior Court of San Juan certified the case as complex civil litigation pursuant to the Authority's petition. On July 27, 2011, Mr. Angel F. Rossy Garcia, a retired Commonwealth appeals court judge, was named as special master for the case. After his appointment, the special master intervened as a neutral evaluator for purposes of assisting the parties in reaching a potential settlement. The parties filed their respective position papers stating their legal contentions and case theories in August 2011. After reviewing the position papers and meeting separately with each party to discuss the strength and weakness of their respective cases, the parties were unable to reach a settlement agreement. The special master then determined that the contested issues would be resolved at trial and that the case would be bifurcated into two phases: a liability phase that would determine whether the termination was wrongful and a damages phase.

The parties in the Litigation are: Abengoa PR, SE (Plaintiff Counterdefendant); PREPA (Defendant Counterplaintiff and Third Party Plaintiff); Abengoa, SA (Third Party Defendant and Counterplaintiff); AIG (Third Party Defendant and Counterplaintiff); UNIPRO (Intervenor) e INDUTECH (Intervenor).

In order to mitigate its possible losses, the Authority entered into an agreement with Washington Engineers P.S.C. for the completion of the generating units, having said units entered into service in 2009. Expert reports have been developed assessing potential damages to be recovered from Abengoa, including excess amounts billed to the Authority prior to the wrongful termination.

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Abengoa Litigation (continued)*

This Complex Litigation was bifurcated into a liability and a damages phase. Trial on the first phase to determine the question of wrongful termination (breach of contract) commenced on January 22, 2015 and was concluded during the course of that same year. Trial on the second phase to determine the questions of damages is scheduled to commence in January 2016. The trial will be heard before designated Special Master Angel F. Rossy at the Superior Court of San Juan.

Economic claims have been reserved for the second phase of trial on damages. PREPA is prepared to prove direct damages arising from the wrongful termination by Abengoa (i.e. direct costs to complete Abengoa's scope of work, equipment refurbishment, etc.) in an amount of at least of $250 million. If recovery of indirect or consequential damages is permitted by the Court, PREPA has claimed in excess of $400 million (including claims for fuel differential costs, los of EPA credits, etc.).

The limit of liability under the EPC Contract is 150% of the Contract Price. This represents a range of between $276 million and $310.5 million depending on which value is considered the Contract Price at the time of termination. The Penal Sum of all Performance Bonds issued by the surety in the aggregate is approximately $190 million.

PREPA understands that is has significant probabilities of prevailing on the merits or its counterclaim for wrongful termination against Abengoa and its surety American International Insurance Company. The evidence will show that Abengoa chose to terminate the Contract with knowledge of or total disregard of the financial damage that such termination would cause PREPA and the People of Puerto Rico.

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Capeco Litigation*

In 2009, a large fire at a tank farm owned by CAPECO caused major damage to surrounding areas. The Authority stored some of its fuel at this facility. In the aftermath of the fire, numerous claims were filed against CAPECO. Some of the plaintiffs included the Authority as a defendant in these suits, alleging that the Authority failed in its duty (as the owner of fuel stored at the site) to properly monitor CAPECO's operations in the tank farm. All cases are in the initial stages and the Authority intends to vigorously defend against these claims. On August 12, 2010, CAPECO filed for bankruptcy. As a result thereof, all proceedings against CAPECO have been stayed.

*Consumer Billing Litigation*

In 2011, separate lawsuits were filed against the Authority by various consumers claiming damages allegedly caused by incorrect and unlawful billing and invoicing practices. Several separate lawsuits, that were filed in 2011, were finally consolidated in the case of Héctor Carmona Resto, et al. v. Autoridad de Energía Eléctrica, Civil No. K AC2011-1265 (907). The case was also certified as a complex litigation, as requested by the Authority. The consumers are claiming damages in excess of $100 million.

The consumers requested that the case be certified as a class action. The Authority filed its Reply to the Master Lawsuit and promptly opposed to the class certification request. The case is in the discovery stage.

PREPA hired an expert witness for the case. PREPA will pursue active litigation in order to show that no class action certification is warranted, and that Plaintiffs' claims have no merit since PREPA's billing and invoicing is made according to the applicable laws and regulations.

PREPA's Expert witness rendered his report. Defendants declined the idea of retaining the services of an expert. Discovery proceedings regarding the class certification issue are being conducted.

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Consumer Billing Litigation (continued)*

In the case of Santiago-Ramos, et al. v. AEE, et al., USDC Civil No. 11-CV01987 (JAF), the complaint was filed on October 6, 2011 by Duamel Santiago-Ramos, Marines Rivera Figueroa individually and as Class Representatives, and Caribbean Economic Council, Inc., against PREPA and Marimar Pérez-Riera, Chair, Board of Directors individually and as President of The Board of Directors. The amount claimed is unspecified.

The complaint claimed (1): that PREPA's rate schedules, including subsidies granted to various groups, violate antitrust law, specifically the Robinson-Patman Act; and (2) that PREPA's rate schedules, including subsidies granted to various groups, violate the First Amendment of the U.S. Constitution, as they "require" customers to associate with religious and political groups they do not agree with by forcing them to subsidize those groups by paying higher energy bills. PREPA does not meet several elements of the Robinson-Patman Act, including the fact that PREPA does not sell electricity outside of Puerto Rico and thus does not meet the interstate commerce requirement. The constitutional claim, in our opinion, is also without merit, first because PREPA is not forcing anyone to associate with anyone else and second because the subsidies that are granted are not granted by PREPA, but instead are mandated by legislation.

PREPA moved for dismissal. The court partially granted the dismissal requested by PREPA. It dismissed the antitrust claims, the substantive due process and equal protection claims, and the claims against co-defendant Marimar Pérez Riera. Plaintiff's First Amendment claim, procedural due process claim and takings claim remained active.

Plaintiffs sought class certification, with PREPA's opposition. PREPA filed a motion for summary judgment requesting dismissal of the remaining claims on the grounds of issue preclusion. The preclusion argument was based on a previous state court case alleging that PREPA's rates are illegal, in which class certification was sought and denied on the merits. The Court denied PREPA's motion for summary judgment and held there was no issue preclusion between the prior state case and this one. An evidentiary hearing for certification as a class was held before a Magistrate Judge, who issued a report and recommendation adopted by the Court.

**16. Commitments and Contingencies (continued)**

**Contingencies (continued)**

*Consumer Billing Litigation (continued)*

According to said report and recommendation, the class certification was held in abeyance, pending discovery on the merits of the constitutional claims. The Court indicated it questioned the plaintiff's First Amendment claims possibility of success in light of the uncontested fact that the subsidies all are ordered by state law. Thus, the Court ordered expedited discovery on the merits of the First Amendment, procedural due process and takings claims. Discovery regarding these issues took place, consisting of both document production and the depositions of several PREPA officials.

As ordered, PREPA timely filed a motion for summary judgment, seeking dismissal of all the remaining constitutional claims above mentioned. Plaintiffs filed their opposition thereto, and while adopting all the uncontested material facts proposed by PREPA, attempted at this late stage to dismiss only their First Amendment Claims and amend the complaint to bring a new constitutional claim. PREPA filed its reply, and among other things, opposed Plaintiff's attempts to change pleadings at such late state. The Judge referred the matter once again to the same Magistrate Judge who had presided the class certification hearing.

The parties are waiting for the Magistrate Judge to issue her Report and Recommendation, as to the pending issues in the case.

In the case of Román-Rivera, et. al. v. AEE, et al., USDC Civil No. 11-2003 (DRD), the complaint was filed on October 9, 2011 by Dario Román Rivera and 9 other plaintiffs against PREPA, the current Acting Executive Director and two former Executive Directors, and 12 members of the PREPA Governing Board. Federal jurisdiction is based upon federal question jurisdiction, and the federal statute cited is the Racketeer Influenced and Corrupt Organizations Act (RICO). The amount claimed is unspecified.

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Consumer Billing Litigation (continued)*

The Complaint consists of five counts, all of which are pursuant to RICO. Count 1 is against PREPA for unlawful use of an enterprise to launder money generated by a pattern of racketeering activity. Count 2 is against the directors and Board members only, for unlawfully acquiring or maintaining an interest in an enterprise through a pattern of racketeering activity. Count 3 is against the directors and Board members only, for unlawful manipulation of an enterprise for purposes of engaging in, concealing, or benefiting from a pattern of racketeering activity. Count 4 is against PREPA, the directors and Board members, for unlawful conspiracy to violate the RICO Act. Count 5 is against PREPA only, and it alleges that PREPA conspired with the other defendants to advance a money-laundering scheme.

The court partially granted the dismissal requested by PREPA. It granted the dismissal of most of the claims, but denied the dismissal of two: conspiracy to advance a money laundering scheme, and conspiracy for acquiring an interest in an enterprise through a pattern of racketeering activity.

Plaintiffs seek class certification. PREPA opposed the certification, and filed a motion for summary judgment to that effect on the grounds of preclusion. The preclusion argument is based on a previous state court case in which class certification was sought and denied on the merits. PREPA's motion for summary judgment was denied. The case proceeded to discovery on the two remaining claims. The parties met and arranged a discovery timetable. PREPA was served an extensive request for production of documents, and served plaintiff a First Set of Interrogatories and Request for Production of Documents. While PREPA has been producing those documents which are not privileged or confidential, plaintiffs have not done likewise, and at present they have yet to answer PREPA's interrogatories. Depositions are in the process of being scheduled.

PREPA believes that the claims that were not dismissed are without merit because the plaintiffs will be unable to prove the necessary elements of those claims. In particular, plaintiffs will not be able to prove that PREPA, as a corporation, conspired through its employees, to violate the RICO ACT, or that its directors or Board members obtained any interest in PREPA (other than their employment).

## 16. Commitments and Contingencies (continued)

### Contingencies (continued)

*Vitol Inc. Litigation*

In 2009, the Authority filed suit in the Commonwealth of P.R. Court of First Instance (the State Court) against Vitol, Inc. and Vitol S.A. (collectively the Vitols) seeking a declaratory judgment as to the nullity of a $2 billion fuel supply agreement due to the Vitols' failure to disclose (a) certain corruption criminal charges to which Vitol S.A. pled guilty and (b) various other investigations. The Vitols removed this suit to federal court and presented a counterclaim alleging that the Authority owed Vitol, Inc. approximately $45 million, consisting of $28 million in fuel that was delivered to, and used by, the Authority and approximately $17 million in excise taxes to be reimbursed to Vitol, Inc. by the Authority.

On November 28, 2012, the Authority filed a second complaint against the Vitols in State Court seeking essentially the same remedies sought in the first action but as to four other certain contracts, after discovery revealed the date in which Vitol learned of the investigations in the corruption cases. The Vitols also removed this action to the U.S. District Court for the District of P.R. The Authority claims approximately $3.5 billion in the aggregate. Vitol, Inc. has resolved the claim for the $17 million in excise taxes and has stated that it will amend its counterclaim to dismiss that claim. Discovery in the case is closed. The parties have submitted motions for summary judgment against each other and the corresponding oppositions and replies thereto. The motions are pending adjudication by the court.

*Asbestos Litigation*

The case of Jorge Martínez, et al. v. AEE, Civil No. K DP2005-1599, which includes fifty-four former and current employees of PREPA, was consolidated with the case of Jose Flores Sanchez v. AEE, Civil No. K DP2010-1708, a retired employee of PREPA. In both cases, plaintiffs claim that they have health problems due to PREPA's intentional failure to comply with federal and local laws regarding handling and exposure to asbestos materials. In particular, plaintiffs claim that, during the years 1972 to 1988, PREPA failed to comply with its duty to protect the plaintiffs from asbestos exposure pursuant to the requirements of OSHA and its regulation, the Constitution of the Commonwealth of Puerto Rico and local applicable laws and regulations. Plaintiffs claim $320.96 million in damages.

**16. Commitments and Contingencies (continued)**

**Contingencies (continued)**

*Asbestos Litigation (continued)*

PREPA alleged employer's immunity under the Workers' Compensation Law. An evidentiary hearing on the issue of liability took place. After trial, the Court entered judgment dismissing both complaints in their entirety. The plaintiffs in the case of Jorge Martínez, et al. v. AEE filed an appeal before the Puerto Rico Appeals Court. PREPA filed a motion to dismiss the appeal. The Appeals court denied PREPA's Motion to Dismiss and PREPA filed its Appellate Brief. The case is pending adjudication by the Court of Appeals.

*Tropical Solar Farm Litigation*

On November 21, 2013, Tropical Solar Farms, LLC; New Horizon Solar, LLC; Jonas Solar Energy, LLC and Roberto Torres Torres (collectively the "Plaintiffs") filed a 58-page suit in the Commonwealth of P.R. Court of First Instance, Ponce Section, against 29 defendants and several John Does. The complaint contains a plethora of claims against multiple defendants arising from an alleged multiplicity of sources of obligations: contractual, in tort, and in breach of fiduciary duties and the law. It encompasses private entities, a public corporation, the Puerto Rico Electric Power Authority ("PREPA") and former public officers, among others. The complaint claims monetary compensation in excess of $705 million.

The complaint alleges that the defendants negotiated several Renewable Power Purchase Agreements to provide up to 40 megawatts to PREPA, all of which were assigned by the plaintiffs to various other defendants. In a nutshell, the Plaintiffs allege that the defendants never intended to comply with their obligations under the agreements, and were only buying time to advance their other renewable energy projects with PREPA.

PREPA filed its answer to the complaint on January 7, 2014. As of this date not all the defendants have answered the complaint, and the discovery proceedings are in a very early stage. Although it is anticipated that the litigation may become a protracted one as a result of the plethora of allegations and defendants, it is our professional evaluation at this early stage of the proceedings that PREPA should not be held liable to Plaintiffs.

## 16. Commitments and Contingencies (continued)

### Construction and Other Commitments

As of June 30, 2014, the Authority has commitments of approximately $47.0 million on active construction, maintenance and engineering services contracts.

### Agreements to Purchase Power

The EcoEléctrica plant is a cogeneration facility located in the Municipality of Peñuelas. The facility includes a combined cycle power block, consisting of one steam and two combustion turbine units, and a liquefied natural gas terminal. The Authority began purchasing power from EcoEléctrica in September 1999 during the testing and start-up phase of the facility. Commercial operation began in March 2000. The Authority entered into an agreement with EcoEléctrica to purchase all of the power produced by the facility for a term of 22 years from the date of commencement of commercial operation. The agreement requires EcoEléctrica to provide 507 MW of dependable generating capacity to the Authority. The Authority may purchase any energy produced by the facility in excess of 507 MW, if made available, by paying an energy charge only. No capacity charge would be imposed on the Authority for this "excess" power. EcoEléctrica has entered into a long-term supply agreement to meet its expected needs for natural gas at the facility.

The power purchase agreement with EcoEléctrica includes monthly capacity and energy charges to be paid by the Authority for the 507 MW of capacity, which EcoEléctrica is committed to provide. The capacity charge is subject to reduction, progressively to zero, if the facility does not achieve certain availability guarantees determined on a 12-month rolling average basis. The energy charges for power purchases are based on a number of factors including a natural gas related charge on a per kWh of energy basis and inflation indices. The EcoEléctrica purchased power costs incorporate a minimum monthly power or fuel purchase requirement based on an average capacity utilization factor on the part of the Authority. After paying this minimum requirement, the Authority only pays for energy actually received (including energy in excess of the 507 MW guaranteed by EcoEléctrica). This element of the agreement, when combined with the possible reduction in the capacity charge described above, effectively transfers substantially all of the economic risk of operating the facility to EcoEléctrica.

## 16. Commitments and Contingencies (continued)

### Agreements to Purchase Power (continued)

The AES-PR plant is a co-generation facility located in the Municipality of Guayama. Commercial operation began in November 2002. This clean burning coal technology facility consists of two identical fluidized bed boilers and two steam turbines with 454 MW of dependable generating capacity. The Authority entered into an agreement with AES-PR to purchase all of the power produced by this facility for a term of 25 years from the date of commencement of commercial operation. The contract with AES-PR is substantially similar to the EcoEléctrica contract described above, including the compensation structure. Above a certain minimum amount, the Authority is only obligated to purchase energy actually produced by the facility. AES-PR is an affiliate of AES Corporation.

The AES-PR and EcoEléctrica projects contribute to the Authority's efforts towards fuel diversification and improved reliability of service. Prior to the commencement of operations of the EcoEléctrica and AES-PR facilities, oil-fired units produced approximately 99% of the Authority's energy. After the incorporation of the EcoEléctrica and AES-PR facilities to the System, approximately 31% of the Authority's annual energy generation is being provided by non-oil-fired generating facilities.

Among other benefits, the integration of the EcoEléctrica and AES-PR cogeneration facilities into the Authority's System reduces the impact of changes in energy costs to the Authority's clients resulting from short-term changes in fuel costs due to the manner of calculation of the energy charges under the EcoEléctrica and AES-PR agreements. While the agreements provide that energy charges will change based on different formulas relating to the prior year, each agreement fixes the energy price for each year of the contract at the beginning of such year. Fixing the energy component of the price for the whole year reduces the impact of seasonal or short duration variations in the market price of electricity. Because the energy price is fixed and known for the entire year, the Authority is able to achieve better economic dispatching and scheduling of maintenance outages of all of its generating units. In addition, the year delay in the effect of energy price changes for these two facilities on the Authority's energy costs reduces variations of the fuel and purchased power components in the price of electricity sold by the Authority by postponing the impact of the price changes and bringing these changes out of step with price changes in the other components of the Authority's fuel mix.

## 16. Commitments and Contingencies (continued)

### Agreements to Purchase Power (continued)

All of the Authority's purchased power costs under the EcoEléctrica and AES-PR power purchase agreements are accounted for as operating expenses on the Authority's financial statements, are treated as a current expense under the Trust Agreement, and are being recovered by the Authority pursuant to the purchased power charge under its current rate structure.

## 17. Recently Issued Accounting Pronouncements

GASB Statement No. 68, *Accounting and Financial Reporting for Pension* – an amendment of GASB Statement No. 27. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. Establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement—determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. This Statement replaces the requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of GASB Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered through trusts or equivalent arrangements that meet certain criteria. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014 (The Authority’s 2015 fiscal year).

The requirements of GASB Statement No. 68 apply to the financial statements of all state and local governmental employers whose employees (or volunteers that provide services to state and local governments) are provided with pensions through pension plans that are administered through trusts or equivalent arrangements as described above, and to the financial statements of state and local governmental non-employer contributing entities that have a legal obligation to make contributions directly to such pension plans. This Statement establishes standards for measuring and recognizing liabilities, deferred outflows of resources, and deferred inflows of resources, and expense/expenditures related to pensions. Note disclosure and Required Supplementary Information requirements about pensions also are addressed. For defined benefit pensions, this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

**17. Recently Issued Accounting Pronouncements (continued)**

The major fundamental change is switching from the existing "funding-based" accounting model, where currently the Annual Required Contribution (ARC) is compared to the actual payments made and that difference determines the Net Pension Obligation (or Asset); to an "accrual basis" model similar to current Financial Accounting Standards Board ("FASB") standards, where the Total Pension Obligation (Actuarially determined) is compared to the Net Plan Position (or assets) and the difference represents the Net Pension Liability or Asset. The information to adopt this Statement will be based on the new actuarial report prepared under the new GASB Statement No. 67. The Authority expects the implementation will have a significant impact to its financial statements.

GASB Statement No. 69 *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. The term "government combinations" is used to refer to a variety of arrangements including mergers and acquisitions. Mergers include combinations of legally separate entities without the exchange of significant consideration. Government acquisitions are transactions in which a government acquires another entity, or its operations, in exchange for significant consideration. Government combinations also include transfers of operations that do not constitute entire legally separate entities in which no significant consideration is exchanged. Transfers of operations may be present in shared service arrangements, reorganizations, redistricting, annexations, and arrangements in which an operation is transferred to a new government created to provide those services. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2013.

GASB Statement No. 71 *Pension Transition for Contributions Made Subsequent to the Measurement Date—an amendment of GASB Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This Statement amends GASB Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.

## 18. Adoption of GASB No. 65 and Prior Period Adjustment

During fiscal year ended June 30, 2014, GASB No.65, *Items Previously Reported as Asset and Liabilities*, became effective, which requires recording the non-insurance portion of deferred debt issuance costs previously presented as Other Assets in the Authority's balance sheets, as operating expenses, and proper classification of certain items previously reported as assets or liabilities as deferred outflows of resources and deferred inflows of resources. As a result of the implementation of GASB 65, starting with the 2014 fiscal year, all debt issuance costs will be presented as expense during the year they are incurred. In addition, a $55.8 million restatement on beginning net position for 2013 was recorded.

| | **2013** | **2012** *and prior* |
|---|---|---|
| Unamortized Debt Issue Costs, *as reported* | $ 55,810 | $ 59,436 |
| Restatement as of June 30, 2012 | (59,436) | (59,436) |
| Restatement as of June 30, 2013 | 3,626 | – |
| Total restatement | (55,810) | (59,436) |
| Unamortized Debt Issue Costs, *as restated* | – | – |
| GASB 65 restatement | (55,810) | (59,436) |
| Net position, *as previously reported* | (791,385) | (515,686) |
| Net position, *as restated* | $(847,195) | $(575,122) |

In addition, deferred loss from debt refunding previously reported as of June 30, 2013, as a decrease of long-term debt (current and non-current) was adjusted as follows:

| | **2013 Balance as previously reported** | **GASB 65 Adjustment** | **2013 Balance as restated** |
|---|---|---|---|
| Deferred outflows of resources | $ – | $ 92,279 | $ 92,279 |
| Current portion of long-term debt | 399,215 | 14,331 | 413,546 |
| Long-term debt, excluding current portion | 7,734,712 | 77,948 | 7,812,660 |

## 19. Financial Condition and Liquidity

The Authority does not currently have sufficient funds available to fully repay its various obligations as they come due, and is working on extending the due date of the obligations and obtaining other concessions from its creditors, including pursuant to an exchange offer that would reduce the principal amount of some of its debts, obtaining more favorable covenants and other terms under its Trust Agreement via a consent solicitation, and obtaining new financing to provide relief and/or funds to repay the existing amounts of principal and interest or bring the outstanding balances current at the various due dates as well as to continue to operate and to finance capital improvement projects. The Commonwealth and its instrumentalities are also experiencing significant financial difficulties and may be unable to continue to repay amounts due to the Authority or to extend, refinance or otherwise provide the necessary liquidity to the Authority as and when needed. The Authority has receivables of over $803.7 million payable by the Commonwealth and related entities and is subject to significant uncertainty with regard to its ability to collect on such receivables. As a consequence, the Authority may not be able to avoid future defaults on its obligations. Management has plans to address the Authority's liquidity situation and continue providing services and believes the Authority will be able to repay or refinance its obligations, as described above and Note 20. However, there can be no assurance that the affiliated or unaffiliated creditors will be able and willing to refinance or modify the terms of the Authority's obligations, that management's current plans to repay or refinance the obligations or extend their terms will be achieved or that certain services will not have to be terminated, curtailed or modified. See further discussion in Note 20.

## 20. Subsequent Events

### Act 57-2014

On May 27, 2014, the Commonwealth of Puerto Rico enacted Act 57 (Act 57-2014), also known as the Transformation and Energy Relief Act of Puerto Rico. The Act provides for, among other things, the creation of the Puerto Rico Energy Commission with regulatory oversight over the Authority's operations, as well as over any other company providing electric energy services in Puerto Rico. The Energy Commission has since been formed, and given supervisory power over the Authority, and many transactions that affect the electrical system and the electric infrastructure of Puerto Rico, including but not limited to, rate setting approval powers. Act 57 also provides for the Authority to set aside two percent (2%) out of the eleven percent (11%) from the fuel and purchase power adjustment clause revenues for deposit to a Rate Stabilization Account with the purpose of stabilizing the price of energy in Puerto Rico.

## 20. Subsequent Events (continued)

### Financial Position

In July 2014, the Authority began discussions with its financial stakeholders in an effort to stabilize the Authority's liquidity situation and address its financial position. The Authority subsequently engaged legal, financial and operational advisors, including a chief restructuring officer, to assist it in those efforts. In the period since July 2014, the Authority has entered into various agreements with certain of its financial stakeholders as discussed below.

### Forbearance Agreements

On August 14, 2014, the Authority entered into forbearance agreements (the "Forbearance Agreements") with certain insurers of the Authority's Power Revenue Bonds ("Bonds") and beneficial owners of the Bonds controlling, collectively, more than 60% of the principal amount of the Bonds then outstanding (comprising the Ad Hoc Group (as defined below)) and the monoline insurers providing credit support for certain of the Authority's Bonds not owned by the Ad Hoc Group (the "monoline bond insurers" and together with the Ad Hoc Group, he "Forbearing Bondholders"), banks that provide revolving lines of credit used to pay for purchased power, fuel and other expenses (together, with their transferees, as applicable, the "Forbearing Lenders") and Government Development Bank for Puerto Rico ("GDB," and together with the Forbearing Bondholders and the Forbearing Lenders, the "Forbearing Creditors").

Under the Forbearance Agreements, the Forbearing Creditors agreed to forbear from the exercise of certain rights and remedies under their applicable debt instruments. The Forbearance Agreements were originally scheduled to terminate on March 31, 2015, but were extended by certain of the Forbearing Creditors on numerous occasions, most recently through November 5, 2015. The Forbearance Agreements expired on November 5, 2015, but the agreement of the Forbearing Creditors to refrain from exercising of certain rights and remedies was extended under the RSA (as defined below).

**20. Subsequent Events (continued)**

**Forbearance Agreements (continued)**

Under the Forbearance Agreements with the Forbearing Bondholders, the Authority's obligations to pay any and all principal and interest payments on the Bonds were required to continue; however, the Forbearing Bondholders agreed that the Authority was not required to make transfers to the Revenue Fund or the Sinking Fund pursuant to sections 506 and 507 of the Trust Agreement while that agreement remained in effect. The Authority has not made monthly cash deposits into the Sinking Fund since July 2014. This agreement was extended and continued under the RSA. Since entry into the Forbearance Agreements, the Authority has paid all principal and interest payments due on the Bonds.

Under the Forbearance Agreements with the Forbearing Lenders, the Authority was permitted until November 5, 2015 to delay certain payments that became due to the Forbearing Lenders in July and August 2014. Under the RSA, the Authority was permitted to delay such payments further until June 30, 2016; however, the Authority has continued to pay interest to the Forbearing Lenders while those agreements remain in effect.

In connection with the Forbearance Agreements and in order to address the Authority's liquidity challenges, on August 27, 2014, the Trust Agreement was amended to permit the Authority to use approximately $280 million held in its construction fund for payment of current expenses in addition to capital improvements. The amendment also provided for an increase in the thresholds required for the exercise of remedies under the Trust Agreement. Those amendments expired on March 31, 2015.

In connection with an extension of the Forbearance Agreements executed on June 30, 2015 and the Authority's agreement to pay approximately $415.8 million of principal and interest due on July 1, 2015 on the Bonds, the Trust Agreement was again amended to increase the thresholds for the exercise of remedies under the Trust Agreement and to allow for the issuance of $130.7 million in Bonds to the monoline bond insurers (the "2015A Bonds") that matured on January 1, 2016. Those amendments expired on September 1, 2015. On December 15, 2015, the Authority defeased the outstanding principal and interest requirements on the 2015A Bonds, and the 2015A Bonds were paid in full on the first business day of January 2016 (January 4, 2016) in accordance with their terms.

**20. Subsequent Events (continued)**

**Bond Payments**

On July 1, 2014, the Authority paid $413.7 million to satisfy the principal and interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves.

On January 2, 2015, the Authority paid $204.4 million to satisfy the interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves.

On July 1, 2015, the Authority paid $415.8 million, to satisfy the principal and interest payments on its Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, including reserves, and a $153.0 million transfer from the General Fund.

On July 31, 2015, pursuant to the Trust Agreement and as agreed with Forbearing Creditors, the Authority issued Power Revenue Bonds Series 2015A, in a par amount of $130.7 million (the Series 2015 A Bonds), to replenish the Authority's working capital. The Series 2015 A Bonds were bought in their entirety by the monoline bond insurers, and the maturity date of this issue was January 1, 2016. The Authority paid $6.1 million, $5.9 million, $5.8 million, $5.8 million and $6.4 million for the first five months that ended on November 1, 2015 to redeem a portion of the Series 2015 A Bonds.

On December 15, 2015, the Authority deposited $103.5 million in escrow to satisfy the remaining principal and interest requirements on the Series 2015 A Bonds, which deposit was funded by $100.9 million from Self-insurance Fund and $2.6 million from General Fund. These amounts were paid to holders of the 2015 A Bonds on January 4, 2016 in accordance with their terms.

On January 4, 2016, the Authority paid $198.0 million, to satisfy the interest payments on its other Bonds due on that date. This payment was funded with moneys in the 1974 Sinking Fund, and a $171.0 million transfer from the General Fund.

**20. Subsequent Events (continued)**

**Agreements with Certain Forbearing Creditors**

Agreement in Principle with Ad Hoc Group

On September 2, 2015, PREPA announced an agreement in principle regarding the economic terms of a restructuring with an ad hoc group of bondholders that were Forbearing Bondholders (the "Ad Hoc Group Agreement") and which group held, at that time, approximately 35% in principal amount of the outstanding Bonds (the "Ad Hoc Group").

Under that agreement, the Ad Hoc Group will have the option to receive securitization bonds that will pay cash interest at a per annum rate of 4.0% - 4.75% (depending on the rating obtained) ("Option A Bonds") or convertible capital appreciation securitization bonds that will accrete interest at a per annum rate of 4.5% - 5.5% for the first five years and pay current interest in cash thereafter at those per annum rates ("Option B Bonds"). Option A Bonds will not pay principal for the first five years (interest only), and Option B Bonds will accrete interest but not receive any cash interest or principal during the first five years. All of PREPA's uninsured bondholders will have an opportunity to participate in the exchange. Both Option A and Option B Bonds would be issued at an exchange ratio of 85% (i.e., with a 15% reduction in principal amount of current holdings of outstanding Bonds).

Under the extension to the Forbearance Agreement with the Ad Hoc Group executed on September 1, 2015, PREPA agreed to work collaboratively and in good faith with the Ad Hoc Group to reach agreement on a recovery plan incorporating these terms. The Ad Hoc Group Agreement was included in the RSA.

Agreement in Principle with Forbearing Lenders of Notes Payables

On September 22, 2015, PREPA announced an agreement in principle regarding economic terms with its Forbearing Lenders (the "Fuel Line Agreement").

Under that Agreement, the Forbearing Lenders, which hold all of the approximately $696 million of matured debt (Notes Payable), will have the option to either (1) convert their existing credit agreements into term loans, with a fixed interest rate of 5.75% per annum, to be repaid over six years in accordance with an agreed amortization schedule or (2) exchange all or part of principal due under their existing credit agreements for new securitization bonds to be issued on the same terms as the Ad Hoc Group.

## 20. Subsequent Events (continued)

### Agreements with Certain Forbearing Creditors (continued)

Agreement in Principle with Forbearing Lenders of Notes Payables (continued)

Under the extensions to the Forbearance Agreements with the Forbearing Lenders executed on September 22, 2015, PREPA agreed to work collaboratively and in good faith with the Forbearing Lenders to reach agreement on a recovery plan incorporating these terms. The Fuel Line Agreement was included in the RSA.

Terms and Status of Restructuring Support Agreement

On November 5, 2015, PREPA announced its entry into a restructuring support agreement (the "Initial RSA") with both the Ad Hoc Group (representing at that time approximately 40% in principal amount of the outstanding Bonds) and the Forbearing Lenders setting forth the agreed-upon terms of PREPA's recovery plan which terms were amended to extend the milestone dates therein on numerous occasions. The economic terms set forth in the Initial RSA are consistent with the Ad Hoc Group Agreement and the Fuel Line Agreement. In addition, pursuant to the Initial RSA, GDB would receive substantially the same treatment on $35.9 million owed by PREPA to it as the Forbearing Lenders will receive. The monoline bond insurers were not party to the Initial RSA.

On December 23, 2015, certain of the monoline bond insurers along with the Ad Hoc Group (representing together at that time approximately 66% in principal amount of the outstanding Bonds), the Forbearing Lenders and GDB, all signed an amended and restated restructuring support agreement (the "A&R RSA" and together with the Initial RSA and the Revised RSA (as defined below), the "RSA" and the Ad Hoc Group, the monoline bond insurers, the Forbearing Lenders and the GDB, together the "Supporting Creditors") with terms and conditions substantially similar to those in the Initial RSA outlined above (including the agreement to exchange Bonds held by the Ad Hoc Group for new securitization bonds at an 85% exchange ratio with a 5-year principal holiday and fixed interest rates).

**20. Subsequent Events (continued)**

**Agreements with Certain Forbearing Creditors (continued)**

<u>Terms and Status of Restructuring Support Agreement (continued)</u>

Significant uncertainty remains as to the potential consummation of the transactions set forth in the RSA, which is subject to a number of material conditions, including without limitation, (1) obtaining legislative authority for the assessment of a special, transition charge on the Authority's customers and other terms to facilitate the issuance of the securitization bonds as well as organizational reforms at the Authority; (2) receipt of an investment grade rating on the new securitization bonds from any credit rating agency that will rate the securitization bonds; (3) obtaining an agreed upon level of participation from holders of the Authority's uninsured Bonds in the exchange offer described above such that no more than $700 million in principal amount of uninsured Bonds shall remain outstanding following the exchange offer, or such higher amount determined by the Authority after consulting with the Authority's advisors; (4) amending the Trust Agreement to increase to at least a majority the percentage of Bondholders required to direct the Trustee to take certain actions under the Trust Agreement, including upon a default by the Authority and continue the waiver of the Authority's obligation to make monthly Sinking Fund deposits, among other things; and (5) obtaining approval and reaching agreement with all Supporting Creditors regarding the definitive documentation of the various restructuring transactions.

The RSA contains a number of termination or withdrawal events in favor of the Supporting Creditors, including if there is a material amendment to certain terms of the recovery plan, if the Authority commences any proceeding under bankruptcy or insolvency law or the Recovery Act (except to implement the recovery plan in accordance with the RSA), as well as the failure to achieve certain milestones by specific dates, including the enactment of legislation containing substantive provisions to implement the recovery plan contemplated by the RSA, among other events, which would result in termination of the RSA or withdrawal from the RSA by individual Supporting Creditors.

On January 23, 2016, the RSA terminated when the PREPA Revitalization Act was not enacted into law and the Ad Hoc Group did not agree to the Authority's request to extend the related RSA milestone. PREPA continued to engage in discussions with the Ad Hoc Group and the other Supporting Creditors regarding a potential extension of the RSA and the transactions contemplated therein and described below.

## 20. Subsequent Events (continued)

### Agreements with Certain Forbearing Creditors (continued)

Terms and Status of Restructuring Support Agreement (continued)

Under the RSA, certain of the Supporting Creditors had agreed to purchase approximately $115 million in Bonds to refund a portion of the interest payments on the Bonds made on January 4, 2016, subject to certain conditions including enactment of the PREPA Revitalization Act in acceptable form. This agreement was formalized in a Bond Purchase Agreement (the "Initial Bond Purchase Agreement") executed on December 29, 2015. The Initial Bond Purchase Agreement also terminated on January 23, 2016 when the A&R RSA terminated. PREPA continued to engage in discussions with the Supporting Creditors regarding the transactions contemplated by the Initial Bond Purchase Agreement.

On January 23, 2016, certain of the Forbearing Lenders agreed to enter into a short form forbearance agreement by which they agreed to forbear from exercising enforcement rights against the Authority under the applicable Fuel Line Agreements through February 12, 2016.

On January 27, 2016, PREPA and the Supporting Creditors executed a revised RSA ("Revised RSA") and a revised Bond Purchase Agreement (the "Revised Bond Purchase Agreement"). The Revised RSA is substantially the same as the A&R RSA, with minor adjustments to address delays in legislative consideration of the PREPA Revitalization Act. The milestone date for legislative approval of the PREPA Revitalization Act was extended to February 16, 2016, and other related milestones were also adjusted accordingly. The Revised Bond Purchase Agreement is substantially the same as the Initial Bond Purchase Agreement, except for certain changes to the timing, conditions and total amount of the contemplated Bond purchase. Under the Revised Bond Purchase Agreement, 50% of the total purchased Bonds will be purchased upon a determination by the applicable Supporting Creditors that the PREPA Revitalization Act satisfies the standards set forth in the RSA and 50% of the total purchased Bonds will be purchased upon the filing of a petition with the Energy Commission seeking approval of a securitization charge that satisfies the standards under the RSA. Under the Revised Bond Purchase Agreement, the total amount of purchased Bonds is approximately $111 million. There can be no assurance, however, that the transactions contemplated by the Revised Bond Purchase Agreement will be consummated.

## 20. Subsequent Events (continued)

### Agreements with Certain Forbearing Creditors (continued)

Terms and Status of Restructuring Support Agreement (continued)

Under the RSA, the Ad Hoc Group has agreed to exchange 100% of its uninsured Bonds for securitization bonds at an 85% exchange ratio. The monoline bond insurers agreed to provide up to $462 million of reserve surety bonds at the time the transaction closes and forward commitments for additional surety capacity to be provided at a later time during the term of the transaction, as credit support for the securitization bonds, that would be available to be drawn upon in the event certain cash reserves and transition payments from PREPA's customers are insufficient to pay current debt service on the securitization bonds. In return for this, (1) the SPV (defined below – see PREPA Revitalization Act) would issue $2.086 billion additional securitization bonds, which amount is subject to adjustment in accordance with the RSA, as credit support for outstanding Authority's insured Bonds to be held in escrow for the benefit of holders of the Authority's insured Bonds and (2) PREPA and the SPV would attempt to refinance certain outstanding Bonds insured by such insurers with securitization bonds during a 6-month period starting 3 years after the date the above exchange closes. The surety bonds provided by the monoline bond insurers would be replaced by SPV cash (derived from transition payments) beginning in FY2019 over a period of nine years, subject to earlier replacement in accordance with certain conditions set forth in the RSA. Among the primary purposes for this transaction are to refinance at a lower cost a portion of the Authority's outstanding Bonds and to improve the Authority's liquidity position during the first five years after issuance. There can be no assurance, however, that the transactions contemplated by the RSA will be consummated.

It should be noted that Bondholders holding beneficially approximately $2.73 billion in principal amount of outstanding Bonds representing approximately 34% in principal amount of the outstanding Bonds, have not agreed to the terms of the RSA, and without access to a statutory restructuring regime the terms of their Bonds also cannot be amended until an agreement with such Bondholders has been reached. As discussed below, the Authority is currently not in compliance with certain terms of its Trust Agreement and such Bondholders, who are not covered by the agreements described above, could direct the trustee to take certain actions, or otherwise exercise enforcement actions, against the Authority, each in accordance with the Trust Agreement, which actions could result in a default being declared.

**20. Subsequent Events (continued)**

**Trust Agreement Covenants**

As a result of the Authority's non-compliance with certain covenants existing under the Trust Agreement, Bondholders not covered by the agreements described above could direct the trustee to take certain actions, or otherwise exercise enforcement actions, against the Authority, including declaring an event of default as a result of covenant violations, each in accordance with the terms of the Trust Agreement.

Under the Trust Agreement, upon a covenant violation, no remedies may be exercised by the trustee on behalf the Bondholders until the trustee notifies the Authority of the particular violation and the Authority does not cure the violation within 30 days after receipt of such notice. The Authority has not received any such notice from the trustee.

**PREPA Revitalization Act**

On November 4, 2015, the Governor submitted the PREPA Revitalization Act to the Legislative Assembly to facilitate the Authority's ongoing transformation and recovery plan. The PREPA Revitalization Act sets forth a framework for PREPA to execute on the agreements with creditors reached to date. Among other things, the PREPA Revitalization Act would (1) enhance PREPA's governance processes; (2) adjust PREPA's practices for hiring and managing management personnel; (3) change PREPA's processes for collecting outstanding bills from public and private entities; (4) improve the transparency of PREPA's billing practices; (5) implement a competitive bidding process for soliciting third party investment in PREPA's infrastructure; (6) authorize the refinancing of outstanding Bonds through a securitization that would reduce PREPA's indebtedness and cost of borrowing; and (7) set forth an expedited process for the Energy Commission to approve or reject PREPA's proposal for a new rate structure that is consistent with its recovery plan. The Legislative Assembly is currently considering various amendments to the PREPA Revitalization Act. There can be no assurance, however, that the PREPA Revitalization Act will be enacted into law or that it will contain provisions that are acceptable to the Authority's various creditors.

## 20. Subsequent Events (continued)

### PREPA Revitalization Act (continued)

As described above, if enacted the PREPA Revitalization Act would provide a legal framework to reduce the Authority's cost of borrowing and its passage in the form contemplated by the RSA is one of the conditions to the execution of the restructuring transactions contemplated by the RSA and described above. The legislation would authorize creation of a bankruptcy-remote, special purpose public corporation (the "SPV"), entirely separate from the Authority, with the power to issue securitization bonds for limited purposes related to the Authority's recovery plan, and to impose non-by passable, transition charges on the Authority's customers. The assessment and periodic automatic adjustments of the transition changes on the Authority's customers would serve as the source of repayment for the securitization bonds.

### U.S. Congress Consideration of Bankruptcy Amendment

Commonwealth officials have been urging the U.S. Congress to amend the federal bankruptcy code to eliminate an exclusion that currently bars any municipality or other instrumentality of the Puerto Rico government from restructuring under the federal bankruptcy code. U.S. legislative discussions on this are expected to continue in January 2016 and beyond.

### Operational Improvements

The Authority has also made significant investments in evaluating and implementing various operational improvements and strategies in an effort to address its ongoing financial challenges.

In an effort to diversify its fuel supply, the Authority has entered into agreements necessary for the construction of an offshore gas port terminal to receive natural gas off the southern part of the island for use in the Aguirre Power Complex. The permitting process for the project is ongoing, and construction has not yet begun. Once operational, the gas port will provide a method to utilize liquefied natural gas at Aguirre.

The Authority reduced its number of employees through a combination of attrition from voluntary retirement and the elimination of temporary and vacant positions. In addition, the Authority continues to enforce the new employee hiring freeze implemented in January 2009.

**20. Subsequent Events (continued)**

**Operational Improvements (continued)**

On September 4, 2014, the Authority appointed a chief restructuring officer whose mandate includes providing overall leadership to the Authority's restructuring process, developing a business plan, implementing revenue improvement and cost reduction plans, overseeing and implementing cash and liquidity management activities, improving the Authority's ability to analyze, track and collect accounts receivable, improving the Authority's capital expenditure plan, and developing plans to improve the Authority's generation, transmission, distribution and other operations.

# Required Supplementary Information

**Schedule I**

Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)

## Supplementary Schedule of Funding Progress

Years Ended June 30, 2014
*(In millions)*

| Actuarial Valuation Date | Actuarial Value of Assets (a) Note 1 | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b)-(a) | Funded Ratio (a)/(b) | Covered Payroll (c) | UAAL Percentage of Covered Payroll [(b)-(a)]/(c) |
|---|---|---|---|---|---|---|
| **Pension Plan** | | | | | | |
| 6/30/2011 | 1,363 | 2,875 | 1,503 | 47% | 361 | 419% |
| 6/30/2012 | 1,285 | 2,986 | 1,701 | 43% | 365 | 466% |
| 6/30/2013 | 1,248 | 3,043 | 1,795 | 41% | 355 | 505% |
| **Postemployment Health Plan*** | | | | | | |
| 7/1/2008 | $ – | $ 587 | $ 587 | 0% | $ 363 | 162% |
| 7/1/2010 | – | 408 | 408 | 0% | 357 | 114% |
| 7/1/2012 | – | 378 | 378 | 0% | 365 | 104% |

***Note 1:*** *The system, as permitted by the GASB, reflects its investments at an average fair market value of the last five years to determine its actuarial funding.*

**Postemployment Health Plan valuation performed every two years, as required by the GASB.*

# Report on Internal Control

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# Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors
Puerto Rico Electric Power Authority

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Puerto Rico Electric Power Authority (the Authority), which comprise the statement of financial position as of June 30, 2014, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated January 28, 2016. Our report includes a reference to other auditors who audited the financial statements of PREPA Holdings LLC (a blended component unit) and PREPA.Net as described in our report on the Puerto Rico Electric Power Authority's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

## Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Authority's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We consider the deficiencies described in the accompanying Schedule of Findings and Responses as items 2014-001 and 2014-002 to be material weaknesses.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

**The Authority's Response to Findings**

The Authority's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

**Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Ernst + Young LLP

January 28, 2016

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affixed to
original of
this report.

# Supplemental Schedules

# Note to Schedules II-VI - Information Required by the 1974 Agreement

As of June 30, 2014 and 2013, and for the Years then Ended

Schedules II - VI present certain information which is required by the 1974 Agreement. The Net Revenues data, as defined in the 1974 Agreement (Net Revenues), presented in Schedules II and III differ in some important respects from generally accepted accounting principles (GAAP). Such differences are explained below; Schedule II also presents a reconciliation of Net Revenues with GAAP.

The most significant differences between Net Revenues and GAAP are the following:

1) Revenues do not include investment income on investments in the construction fund (see Note 5 to the financial statements);
2) Depreciation and interest expense on bonds covered by the 1974 Agreement are not included as deductions in calculating Net Revenues;
3) Amortization of debt discount and issuance costs and the allowance for funds used during construction are not considered in the computation in calculating Net Revenues;
4) Contribution in lieu of taxes is not considered a deduction for purposes of Net Revenues;
5) Net Revenues do not include revenues or expenses of the Irrigation Systems (see Note 1 to the financial statements).

For further details and information on the definition of Net Revenues, please refer to the 1974 Agreement.

**Schedule II**

Puerto Rico Electric Power Authority

Sources and Disposition of Net Revenues
Under the Provisions of the 1974 Agreement
Statements of Income (GAAP)
and Reconciliation of Net Income

Years Ended June 30, 2014 and 2013
*(In thousands)*

| | 2014 | | | 2013 | | |
|---|---|---|---|---|---|---|
| | 1974 Trust Agreement | Statement of Income (GAAP) | Reconciliation of Net Income | 1974 Trust Agreement | Statement of Income (GAAP) | Reconciliation of Net Income |
| **Reconciliation of components of net income:** | | | | | | |
| Revenues: | | | | | | |
| Operating revenues | $ 4,444,610 | $ 4,468,922 | | $ 4,821,348 | $ 4,843,016 | |
| Other operating revenues | 32,577 | 32,577 | | 28,405 | 28,136 | |
| Other | (9,986) | 22,416 | | 1,064 | (2,773) | |
| 1974 agreement construction fund investment income and gain on sale of other properties | (4,038) | 48,996 | | – | 32,945 | |
| | 4,463,163 | 4,572,911 | $ 109,748 | 4,850,817 | 4,901,324 | $ 50,507 |
| Current Expenses: | | | | | | |
| As shown | 3,886,765 | 3,904,924 | | 4,125,390 | 4,138,988 | |
| Total as defined | 3,886,765 | 3,904,924 | (18,159) | 4,125,390 | 4,138,988 | (13,598) |
| Net revenues, as defined | $ 576,398 | | | $ 725,427 | | |
| Depreciation | | 341,511 | (341,511) | | 344,653 | (344,653) |
| Other post-employment benefit (OPEB) | | (543) | 543 | | 5,338 | (5,338) |
| Disposition of Revenues: | | | | | | |
| (not classified in order of payment) | | | | | | |
| Interest on debt | $ 359,556 | 431,021 | | $ 332,504 | 399,641 | |
| Interest on general obligation notes | 6,872 | 45,054 | | 458 | 741 | |
| Amortization of debt discount, financing expenses | – | (11,593) | | – | (14,511) | |
| Amortization of bond defeasance | – | 14,330 | | – | 15,061 | |
| Allowance for funds used during construction | – | (9,759) | | – | (14,065) | |
| Net interest on long-term debt | 366,428 | 469,053 | (102,625) | 332,962 | 386,867 | (53,905) |
| Power revenue bonds: | | | | | | |
| Principal | 204,305 | – | 204,305 | 194,920 | | 194,920 |
| Appropriation capital improvement fund | (2,124) | – | (2,124) | 16,986 | | 16,986 |
| Appropriation reserve account | (41,480) | – | (41,480) | – | | – |
| Contribution in lieu of taxes | 49,269 | 277,776 | (228,507) | 180,559 | 297,551 | (116,992) |
| Total expenses (GAAP) | | 4,992,721 | | | 5,173,397 | |
| Net revenues, as defined | $ 576,398 | | | $ 725,427 | | |
| Net income | | $ (419,810) | $ (419,810) | | $ (272,073) | $ (272,073) |

Puerto Rico Electric Power Authority

Supplemental Schedule of Sources and Disposition
of Net Revenues under the Provisions of the 1974 Agreement

Years Ended June 30, 2014 and 2013
*(In thousands)*

| | 2014 | 2013 |
|---|---|---|
| **Sources of Net Revenues:** | | |
| **Revenues:** | | |
| Electric revenues | **$ 4,444,610** | $ 4,821,348 |
| Other operating revenues | **32,577** | 28,405 |
| Other (principally interest) | **(14,024)** | 1,064 |
| | **4,463,163** | 4,850,817 |
| **Current Expenses:** | | |
| Operations: | | |
| Fuel | **2,345,000** | 2,603,578 |
| Purchased Power | **807,620** | 755,686 |
| Other productions | **64,381** | 71,655 |
| Transmissions and distributions | **172,392** | 172,318 |
| Customer accounting and collection | **111,406** | 116,351 |
| Administrative and general | **188,641** | 191,912 |
| Maintenance | **197,325** | 213,890 |
| | **3,886,765** | 4,125,390 |
| **Net revenues, as defined** | **$ 576,398** | $ 725,427 |
| **Disposition of Net Revenues:** | | |
| **Revenue fund:** | | |
| Power revenue bonds - sinking fund requirements: | | |
| Interest | **$ 359,556** | $ 332,504 |
| Principal | **204,305** | 194,920 |
| Reserve Account | **(41,480)** | – |
| Balance available for capital improvements and other needs | **(2,124)** | 16,986 |
| | **520,257** | 544,410 |
| **General obligation notes:** | | |
| Interest | **6,872** | 458 |
| **Contribution in lieu of taxes and other** | **49,269** | 180,559 |
| **Net revenues, as defined** | **$ 576,398** | $ 725,427 |

Puerto Rico Electric Power Authority

Supplemental Schedule of Funds Under the Provisions of the 1974 Agreement

Years Ended June 30, 2014 and 2013
*(In thousands)*

| | 2014 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | | Held by Authority | Restricted Deposits with Trustee | | | Held by Authority | Restricted Deposits with Trustee | |
| | Total | Other Assets | Other Assets | Non-Current Assets | Total | Other Assets | Other Assets | Non-Current Assets |
| **By Account:** | | | | | | | | |
| 1974 Agreement (restricted): | | | | | | | | |
| Sinking Fund - principal and interest | **$ 328,532** | **$ –** | **$ 328,532** | **$ –** | $ 369,381 | $ – | $ 369,381 | $ – |
| Reserve account | **453,323** | **–** | **–** | **453,323** | 398,472 | – | – | 398,472 |
| Self Insurance Fund | **96,080** | **–** | | **96,080** | 92,217 | – | | 92,217 |
| Sinking Fund - Capitalized Interest | **124,992** | **–** | **–** | **124,992** | 62,913 | – | – | 62,913 |
| Reserve Maintenance Fund | **15,949** | **15,949** | **–** | **–** | 15,818 | 15,818 | – | – |
| Other Restricted Fund | **1,900** | **1,900** | **–** | **–** | 12,370 | 12,370 | – | – |
| Construction Fund: | | | | | | | | |
| Rural Utilities Services (RUS) | **1,463** | **1,463** | **–** | **–** | 1,103 | 1,103 | – | – |
| Other | **303,434** | **303,434** | **–** | **–** | 49,370 | 49,370 | – | – |
| PREPA Client Fund | **3,177** | **3,177** | **–** | **–** | 4,759 | 4,759 | – | – |
| General purpose (unrestricted) | | | | | | | | |
| General (excluding Prepa Net) | **136,305** | **136,305** | **–** | **–** | 111,817 | 111,817 | – | – |
| Working funds | **996** | **996** | **–** | **–** | 807 | 807 | – | – |
| Total | **$ 1,466,151** | **$ 463,224** | **$ 328,532** | **$ 674,395** | $ 1,119,027 | $ 196,044 | $ 369,381 | $ 553,602 |
| **By Type of Assets Held:** | | | | | | | | |
| Working funds | **$ 996** | **$ 996** | **$ –** | **$ –** | $ 807 | $ 807 | $ – | $ – |
| PREPA Client Fund | **3,177** | **3,177** | **–** | **–** | 4,759 | 4,759 | – | – |
| Cash in bank and time deposits (by depository institutions): | | | | | | | | |
| Government Development Bank for Puerto Rico | **399,301** | **399,301** | **–** | **–** | 2,638 | 2,638 | – | – |
| Banco Popular de Puerto Rico | **36,936** | **36,936** | **–** | **–** | 31,362 | 31,362 | – | – |
| Citibank, N. A. | **5,961** | **5,961** | **–** | **–** | 78,001 | 78,001 | – | – |
| US Bank | **328,597** | **65** | **328,532** | **–** | 414,630 | 45,249 | 369,381 | – |
| Banco Bilbao Vizcaya (Chase), Puerto Rico | **1,955** | **1,955** | **–** | **–** | 10,807 | 10,807 | – | – |
| Banco Bilbao Vizcaya, Mayaguez, Puerto Rico | **188** | **188** | **–** | **–** | 179 | 179 | – | – |
| Banco Bilbao Vizcaya, Call Center | **9,632** | **9,632** | | | 18,548 | 18,548 | | |
| FirstBank, San Juan, Puerto Rico | **2,663** | **2,663** | **–** | **–** | 748 | 748 | – | – |
| Banco Santander, San Juan, Puerto Rico | **(5,131)** | **(5,131)** | **–** | **–** | 2,922 | 2,922 | – | – |
| RG Premier Bank | **7,481** | **7,481** | **–** | **–** | 24 | 24 | – | – |
| Western Bank, Mayaguez, P.R. | **–** | **–** | **–** | **–** | – | | – | – |
| JP Morgan | **–** | **–** | **–** | **–** | – | – | – | – |
| Other Institutions | **–** | **–** | **–** | **–** | – | – | – | – |
| | **791,756** | **463,224** | **328,532** | **–** | 565,425 | 196,044 | 369,381 | – |
| Investment Securities | **674,395** | **–** | **–** | **674,395** | 553,602 | – | – | 553,602 |
| Total | **$ 1,466,151** | **$ 463,224** | **$ 328,532** | **$ 674,395** | $ 1,119,027 | $ 196,044 | $ 369,381 | $ 553,602 |

**Schedule V**

Puerto Rico Electric Power Authority

Supplemental Schedule of Changes in Cash and Investments by Funds

Year Ended June 30, 2014

*(In thousands)*

| | | General Purposes Funds | | | Sinking Fund | | | | Other Funds | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2013-2014 Activity** | **Total** | **General Fund** | **Revenue Fund** | **Working Fund** | **Interest 1974 Agreement** | **Principal 1974 Agreement** | **Reserve 1974 Agreement** | **Self Insurance Fund** | **Construction 1974 Agreement** | **Reserve Maintenance Fund** | **Subordinated Obligation Fund** | **Other Restricted Fund** |
| **Balances at June 30, 2013, before interfund account** | $ 1,119,027 | $ 427,821 | $ 770 | $ 807 | $ 236,805 | $ 195,489 | $ 398,472 | $ 92,217 | $ (266,301) | $ 15,818 | $ – | $ 17,129 |
| Operations: | – | | | | | | | | | | | |
| Actual Net revenues | – | (769,465) | 192,450 | | 329,597 | 187,280 | – | – | 15,392 | | 44,746 | |
| Funds provided from internal operations | 912,263 | 912,263 | | | | | | | | | | |
| 1974 Agreement investment income Acct 4191 | – | (4,037) | | | | | | | 4,037 | | | |
| Investment income and other | 12,140 | | | | 1,878 | 664 | 4,989 | 1,513 | 3,026 | 70 | | |
| Unrealized gain (or loss) on market value of investment | 6,849 | | | | 1,030 | | 3,423 | 2,335 | | 61 | | |
| Offset of current year's contribution in lieu | – | | | | | | | | | | | |
| of taxes against certain government accounts | – | | | | | | | | | | | |
| receivable | – | 152,224 | (152,224) | | | | | | | | | |
| Offset of current year's 5% contribution in lieu of | – | | | | | | | | | | | |
| taxes against Commonwealth of Puerto | – | | | | | | | | | | | |
| Rico debt and transfers to General Obligations | – | 40,226 | (40,226) | | | | | | | | | |
| Funds used for construction | (255,547) | | | | | | | | (255,547) | | | |
| Reclassified construction costs for deferred debits | – | – | | | | | | | | | | |
| Proceeds from Federal Agencies and Insurance Companies | – | | | | | | | | | | | |
| Financing: | – | | | | | | | | | | | |
| Proceeds from new bond issues-net of | – | | | | | | | | | | | |
| original discounts | 656,086 | | | | 109,647 | | 46,439 | | 500,000 | | – | |
| Proceeds from Contributed Capital | 4,358 | | | | | | | | 4,358 | | | |
| Proceeds from refunding bonds issues-net of | – | | | | | | | | | | | |
| original discounts | – | | | | | | | | | | | |
| Defeased bonds-net of original discounts | – | | | | | | | | | | | |
| Sinking Funds and account transfers | – | 10,297 | | | 1,673 | | | | 5,000 | | | (16,970) |
| Notes issued for construction | – | | | | | | | | | | | |
| Notes issued to working capital | 116,527 | 116,527 | | | | | | | | | | |
| Note issued to finance the acquisition on fuel oil | 1,582,238 | 1,582,238 | | | | | | | | | | |
| Payment of notes payable | (1,723,054) | (1,723,054) | | | | | | | | | | |
| Payment of interest | (445,080) | (28,360) | | | (409,847) | | | | | | (6,873) | |
| Swap termination fees paid | (37,873) | | | | | | | | | | (37,873) | |
| Payment of current maturities of long-term debt | (194,920) | | | | | (194,920) | | | | | | |
| Proceeds from Prepa Holding | 4,918 | | | | | | | | | | | 4,918 |
| Changes in assets and liabilities: | – | | | | | | | | | | | |
| Working funds | – | (189) | | 189 | | | | | | | | |
| Accounts receivable (includes non-current) | (516,699) | (516,699) | | | | | | | | | | |
| Fuel oil | 156,854 | 156,854 | | | | | | | | | | |
| Materials and supplies | 899 | 899 | | | | | | | | | | |
| Prepayments and other | 4,607 | 4,607 | | | | | | | | | | |
| Deferred debits | (3,023) | (3,023) | | | | | | | | | | |
| Accounts payable and accrued liabilities | | | | | | | | | | | | |
| (includes non-current) | 62,481 | 41,461 | | | | | | | 21,020 | | | |
| Customer deposits | 3,100 | 3,100 | | | | | | | | | | |
| Adjustment | | (14,225) | | | | | | | 14,225 | | | |
| Interfund transfers, etc. | – | 8,093 | (756) | – | (5,767) | (5) | | 15 | (1,580) | – | – | |
| Total before interfund accounts | 1,466,151 | 397,558 | 14 | 996 | 265,016 | 188,508 | 453,323 | 96,080 | 43,630 | 15,949 | – | 5,077 |
| Add (deduct) Interfund accounts | – | (261,267) | – | – | – | – | – | – | 261,267 | – | – | – |
| **Balances at June 30, 2014** | $ 1,466,151 | $ 136,291 | $ 14 | $ 996 | $ 265,016 | $ 188,508 | $ 453,323 | $ 96,080 | $ 304,897 | $ 15,949 | $ – | $ 5,077 |

Puerto Rico Electric Power Authority

Supplemental Schedule of Changes in Cash and Investments by Funds (continued)

Year Ended June 30, 2013
*(In thousands)*

| | | General Purposes Funds | | | Sinking Fund | | | | Other Funds | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2012-2014 Activity** | **Total** | **General Fund** | **Revenue Fund** | **Working Fund** | **Interest 1974 Agreement** | **Principal 1974 Agreement** | **Reserve 1974 Agreement** | **Self Insurance Fund** | **Construction 1974 Agreement** | **Reserve Maintenance Fund** | **Subordinated Obligation Fund** | **Other Restricted Fund** |
| **Balances at June 30, 2012, *before interfund accounts*** | $ 1,455,539 | $ 449,740 | $ 14 | $ 886 | $ 296,060 | $ 185,974 | $ 401,735 | $ 90,372 | $ 10,297 | $ 15,809 | $ – | $ 4,652 |
| Operations: | | | | | | | | | | | | |
| Net revenues | – | (725,427) | 180,559 | – | 332,503 | 194,920 | – | | 16,986 | – | 459 | – |
| Funds provided from internal operations | 743,318 | 743,318 | – | – | – | – | – | – | – | – | – | – |
| 1974 Agreement investment income Acct 4191 | – | (966) | – | – | – | – | – | – | 966 | – | – | – |
| Investment income and other | 31,870 | 14,691 | – | – | 10,146 | 441 | 3,360 | 1,296 | 1,872 | 57 | – | 7 |
| Unrealized gain (or loss) on market value of investment | (7,339) | – | – | – | (1,218) | – | (6,622) | 549 | – | (48) | – | – |
| Offset of current year's contribution in lieu of taxes against certain government accounts receivable | – | 138,198 | (138,198) | – | – | – | – | – | – | – | – | – |
| Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to General Obligations | – | 42,360 | (42,360) | – | – | – | – | – | – | – | – | – |
| Funds used for construction | (314,905) | – | – | – | – | – | – | – | (314,905) | – | – | – |
| Reclassified construction costs for deferred debits | – | – | – | – | – | – | – | – | – | – | – | – |
| Proceeds from Federal Agencies and Insurance Companies | 6,981 | – | – | – | – | – | – | – | 6,981 | – | – | – |
| Financing: | | | | | | | | | | | | |
| Proceeds from new bond issues-net of original discounts | – | – | – | – | – | – | – | – | – | – | – | – |
| Proceeds from Contributed Capital | 10,898 | – | – | – | – | – | – | – | 10,898 | – | – | – |
| Proceeds from refunding bonds issues-net of | | | | | | | | | | | | – |
| original discounts | – | – | – | – | – | – | – | – | – | – | – | – |
| Defeased bonds-net of original discounts | – | – | – | – | – | – | – | – | – | – | – | – |
| Sinking Funds and account transfers | – | (8,699) | – | – | (1,649) | (243) | – | – | 14 | – | 107 | 10,470 |
| Notes issued for construction | – | – | – | – | – | – | – | – | – | – | – | – |
| Notes issued to working capital | 32,921 | 32,921 | – | – | – | – | – | – | – | – | – | – |
| Note issued to finance the acquisition on fuel oil | 1,468,736 | 1,468,736 | – | – | – | – | – | – | – | – | – | – |
| Payment of notes payable | (1,355,720) | (1,355,720) | – | – | – | – | – | – | – | – | – | – |
| Payment of interest | (414,877) | (16,611) | – | – | (397,700) | – | – | – | – | – | (566) | – |
| Payment of current maturities of long-term debt | (185,605) | – | – | – | – | (185,605) | – | – | – | – | – | |
| Proceeds from Prepa Holding | 2,000 | – | – | – | – | – | – | – | – | – | – | 2,000 |
| Changes in assets and liabilities: | – | – | – | – | – | – | – | – | – | – | – | – |
| Working funds | – | 79 | – | (79) | – | – | – | – | – | – | – | – |
| Accounts receivable (includes non-current) | (376,046) | (376,046) | – | – | – | – | – | – | – | – | – | – |
| Fuel oil | (74,438) | (74,438) | – | – | – | – | – | – | – | – | – | – |
| Materials and supplies | 580 | 580 | – | – | – | – | – | – | – | – | – | – |
| Prepayments and other | (5,020) | (5,020) | – | – | – | – | – | – | – | – | – | – |
| Deferred debits | (6,881) | (6,881) | – | – | – | – | – | – | – | – | – | – |
| Accounts payable and accrued liabilities (includes non-current) | 101,681 | 101,681 | – | – | – | – | – | – | – | – | – | – |
| Customer deposits | 5,334 | 5,334 | – | – | – | – | – | – | – | – | – | – |
| Interfund transfers, etc. | – | (9) | 755 | – | (1,337) | 2 | (1) | – | 590 | – | – | – |
| Total before interfund accounts | 1,119,027 | 427,821 | 770 | 807 | 236,805 | 195,489 | 398,472 | 92,217 | (266,301) | 15,818 | – | 17,129 |
| Add (deduct) Interfund accounts | – | (316,774) | – | – | – | – | – | – | 316,774 | – | – | – |
| **Balances at June 30, 2013** | $ 1,119,027 | $ 111,047 | $ 770 | $ 807 | $ 236,805 | $ 195,489 | $ 398,472 | $ 92,217 | $ 50,473 | $ 15,818 | $ – | $ 17,129 |

# Puerto Rico Electric Power Authority

## Supplemental Schedule of Changes in Long-Term Debt and Current Portion of Long-Term Debt

Years Ended June 30, 2014 and 2013
*(In Thousands)*

| | 2014 | 2013 |
|---|---|---|
| **Long-term debt, excluding current portion:** | | |
| **Balance at beginning of year** | **$ 7,812,660** | $ 8,042,587 |
| Transfers to current liabilities: | | |
| Power revenue bonds | **(227,561)** | (218,626) |
| Notes payable | **27,856** | (156,546) |
| Payment of general obligation notes: | | |
| Notes payable | **(1,734,188)** | (1,356,411) |
| Remainder | **5,878,767** | 6,311,004 |
| New Issues: | | |
| Power revenue bonds | **673,145** | – |
| Power revenue refunding bonds | **–** | – |
| Debt discount on new bond issues - net | **(14,806)** | – |
| Defeasance of bonds | **–** | – |
| Debt discount on cancelled bonds - net | **–** | – |
| Notes payable | **1,709,900** | 1,501,656 |
| **Balance at end of year** | **$ 8,247,006** | $ 7,812,660 |
| **Current portion of long-term debt:** | | |
| **Balance at beginning of year** | **$ 1,165,311** | $ 1,000,256 |
| Transfer from long-term debt | **199,705** | 365,172 |
| Payments to bondholders: | | |
| Power revenue- July 1 | **(194,920)** | (185,605) |
| Amortization of debt discount | **(13,907)** | (14,512) |
| **Balance at end of year** | **$ 1,156,189** | $ 1,165,311 |