



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, 2009 and 2008  
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, 2009 and 2008

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## Report of Independent Auditors

To the Governing Board of the  
Puerto Rico Electric Power Authority

We have audited the accompanying financial statements of the Puerto Rico Electric Power Authority (the Authority), a component unit of the Commonwealth of Puerto Rico, as of and for the years ended June 30, 2009 and 2008, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of PREPA Networks, Inc. (PREPA.Net) (a blended component unit), which financial statements reflect total assets constituting approximately .2%% and .2% of total assets as of June 30, 2009 and 2008, and revenues constituting .2% and .1% 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.Net, is based solely on the report 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. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the reports of the other auditors, provide a reasonable basis for our 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 Authority as of June 30, 2009 and 2008, 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.

In accordance with *Government Auditing Standards*, we have also issued our report, dated December 30, 2009, 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.

Management's Discussion and Analysis on pages 3 through 13 and the required supplementary information disclosed on page 67 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board (GASB). We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements of the Puerto Rico Electric Power Authority. The supplemental information included in Schedules II - VI is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplemental information included in Schedules II - VI has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole, and is prepared in accordance with the terms of the 1974 Agreement (described herein).

*Ernst & Young LLP*

December 30, 2009

Stamp No. 2464490  
affixed to  
original of  
this report.

Puerto Rico Electric Power Authority  
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Management's Discussion and Analysis

June 30, 2009

This section of the financial report of Puerto Rico Electric Power Authority (the Authority) presents the analysis of the Authority's financial performance during the fiscal years ended June 30, 2009, 2008 and 2007. 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, 2009 was \$362.6 million representing an increase of 100 percent over the fiscal year ended June 30, 2008. For the fiscal years ended June 30, 2008 and 2007 was \$181.1 million and \$370.9 million respectively, representing a 51.1 percent decrease and an 8.0 percent decrease when compared to fiscal years ended June 30, 2008 and 2007 respectively.
- Operating expenses decreased by \$541.0 million or 12.9 percent for the fiscal year ended June 30, 2009; increased by \$871.7 million or 26.3 percent and decreased by \$3.6 million or 0.1 percent for the fiscal years ended June 30, 2008 and 2007, respectively, when compared to previous fiscal years.
- The Authority's Net Utility Plant for the fiscal year ended June 30, 2009 increased by \$236.2 million or 3.8 percent. For the fiscal year ended 2008 and 2007 the increase was \$419.4 million and \$316.9 million or 7.3 percent and 5.8 percent, respectively. Total assets decreased by \$450.0 million, increased by \$989.9 million and \$823.6 million or 4.9 percent decrease, 12.0 percent increase and 11.1 percent increase, respectively, for the fiscal years ended June 30, 2009, 2008 and 2007.
- For the fiscal year ended June 30, 2009, as compared to the fiscal year ended June 30, 2008, accounts receivable decreased from \$1,272.8 million to \$1,126.9 million, representing an 11.5 percent. The decrease was mainly due to a collection of \$136.7 million from insurance companies related to a claim filed as a result of two fires at the Palo Seco Steam Plant, and to a decline in the average fuel oil per barrel of 7.95 (9.4%) Accounts receivable from the governmental sector increased from \$357.3 million on June 30, 2008 to \$471.4 million on June 30, 2009, representing a 31.9 percent.

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Management's Discussion and Analysis (continued)

- The Authority's net assets decreased by \$147.5 million (79.0 percent), \$284.7 million (60.4 percent) and \$39.8 million (7.8 percent) as a result of operations during fiscal years ended June 30, 2009, 2008 and 2007, respectively.
- Ratios of fuel and purchased power adjustment revenues to total operating revenues were 72.8 percent for 2008-2009, 73.8 percent for 2007-2008 and 67.6 percent for 2006-2007.
- Ratios of fuel oil and purchased power expenses to total operating expenses (excluding depreciation expense) were 77.7 percent for 2008-2009, 76.3 percent for 2007-2008 and 77.4 percent for 2006-2007.
- The decrease in the fuel adjustment revenues and fuel expense for fiscal year 2009 as compared to 2008 of \$311.6 million and \$383.2 million, respectively, was mainly due to a decrease in the average fuel oil price per barrel of \$7.95 (9.4%) and a decrease of 2.2 million (7.9%) in the consumption of fuel oil barrels for 2008-2009. The increase in the fuel adjustment revenues and fuel expense for fiscal year 2008 as compared to 2007 of \$695.0 million and \$586.1 million, respectively, was mainly due to an increase in fuel oil price per barrel of \$26.63 (46.3%). In addition, the decrease in the fuel adjustment revenues for fiscal year 2007 as compared to 2006 of \$90.3 million was mainly due to the excess of fuel expenses of \$123 million associated with alternate generation capacity as a result of the Palo Seco Steam Plant fires, which are being recovered from insurance companies. The increase in the fuel expenses for fiscal year 2007 as compared to 2006 of \$51.1 million was mainly due to an increase in fuel oil price per barrel of \$1.17 (2.1 percent).
- The increase in the purchased power adjustment revenue and expense of \$6.9 million and \$10.8 million, respectively, was due to an increase of 1.0 cent (9.9 percent) per kWh in average price of purchase power for fiscal 2009 when compared to fiscal 2008. The increase in the purchased power adjustment revenue and expense of \$36.8 million and \$36.4 million, respectively, was mainly due to an increase of 312,676 MWh (4.5 percent) in purchased power for fiscal 2008 when compared to 2007. The increase in the purchased power adjustment revenue and expense of \$34.5 million and \$21.5 million, respectively, was mainly due to an increase of 311,279 MWh (4.6 percent) purchase power for fiscal 2007 when compared to fiscal 2006.

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Management's Discussion and Analysis (continued)

- For the fiscal year ended June 30, 2008, as compared to the fiscal year ended June 30, 2007, accounts receivable increased from \$994.6 million on June 30, 2007 to \$1,272.8 million on June 30, 2008, representing a 28.0 percent. The increase was mainly due to a claim to insurance companies related to the costs associated with alternate generation capacity in connection with two fires at the Palo Seco Steam Plant. The increase was also due to fuel oil prices that increased \$26.63 (46.3%) per barrel. Accounts receivable from the governmental sector increased from \$316.6 million on June 30, 2007 to \$357.3 million on June 30, 2008, representing a 12.8 percent.
- For the fiscal year ended June 30, 2007, as compared to the fiscal year ended June 30, 2006, accounts receivable increased from \$837.3 million on June 30, 2006 to \$994.6 million on June 30, 2007, representing an 18.8 percent. The increase was mainly due to a claim to insurance companies related to the costs associated with alternate generation capacity in connection with two fires mentioned above. Accounts receivable from the governmental sector increased from \$265.9 million on June 30, 2006 to \$316.6 million on June 30, 2007, representing a 19.1 percent increase.

### 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 Networks Corp., which include a Balance Sheet, Statement of Revenues, Expenses and Changes in Net Assets, Statement of Cash Flows and the notes to financial statements.

PREPA Networks, Corp. issues 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.

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Management's Discussion and Analysis (continued)

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

The Statement of Revenues, Expenses and Changes in Net Assets presents 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. The 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 the detail accounting books and records.

**Financial Analysis**

The Authority's net assets decreased by \$147.4 million, \$284.7 million and \$39.8 million for the fiscal years ended June 30, 2009, 2008 and 2007, respectively. Our analysis below focuses on the Authority's net assets and changes in net assets during the year.

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

|                                       | <b>2009</b>         | <b>2008</b>  | <b>2007</b>  |
|---------------------------------------|---------------------|--------------|--------------|
| Current, non-current and other assets | <b>\$ 2,371,432</b> | \$ 3,057,603 | \$ 2,487,122 |
| Capital assets                        | <b>6,410,173</b>    | 6,173,993    | 5,754,568    |
| Total assets                          | <b>\$ 8,781,605</b> | \$ 9,231,596 | \$ 8,241,690 |

Puerto Rico Electric Power Authority  
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Management's Discussion and Analysis (continued)

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

|   | <b>2009</b>         | <b>2008</b>  | <b>2007</b>  |
|---|---------------------|--------------|--------------|
| Long-term debt outstanding                      | \$ <b>6,843,137</b> | \$ 7,113,832 | \$ 6,127,770 |
| Other liabilities                               | <b>1,899,249</b>    | 1,931,082    | 1,642,512    |
| Total liabilities                               | <b>\$ 8,742,386</b> | \$ 9,044,914 | \$ 7,770,282 |
|   |                     |              |              |
| Net assets:                                     |                     |              |              |
| Invested in capital assets, net of related debt | \$ <b>19,433</b>    | \$ 55,101    | \$ 168,307   |
| Restricted                                      | <b>233,208</b>      | 307,666      | 315,154      |
| Unrestricted                                    | <b>(213,422)</b>    | (176,085)    | (12,053)     |
| Total net assets                                | <b>\$ 39,219</b>    | \$ 186,682   | \$ 471,408   |

A significant portion of the Authority's net assets is restricted and represents resources that are subject to external restrictions on how they may be used. An additional portion of the Authority's net assets reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding.

Net assets invested in utility plant, net of related debt decreased from \$55.1 million in 2007-2008 to \$19.4 million in 2008-2009 (64.7 percent) mainly due to increases in the interim financing of construction expenditures to compensate a reduction in the availability of internal funds allocated to the construction activity.

Restricted for capital and debt service decreased by \$74.5 million (24.2%) from \$307.7 million as of June 30, 2008 to \$233.2 million as of June 30, 2009. The decrease was mainly due to a reduction in construction fund balances used to finance the annual capital improvement program. Also, as allowed by the 1974 Trust Agreement, cash reserves in excess of required balances were transferred to debt service accounts.

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

Puerto Rico Electric Power Authority  
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Management's Discussion and Analysis (continued)

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

|  | <b>Year Ended June 30</b> |              |              |
|--|---------------------------|--------------|--------------|
|  | <b>2009</b>               | <b>2008</b>  | <b>2007</b>  |
| Operating revenues   | <b>\$ 4,002,713</b>       | \$ 4,362,209 | \$ 3,680,390 |
| Other income   | <b>25,326</b>             | 25,874       | 20,942       |
| Total revenues   | <b>4,028,039</b>          | 4,388,083    | 3,701,332    |
| Operating expenses   | <b>3,640,109</b>          | 4,181,143    | 3,309,445    |
| Interest expense, net  | <b>326,165</b>            | 312,269      | 296,209      |
| Total expenses   | <b>3,966,274</b>          | 4,493,412    | 3,605,654    |
| (Loss)/Income before contribution in lieu of taxes and other and contributed capital | <b>61,765</b>             | (105,329)    | 95,678       |
| Contribution in lieu of taxes and other  | <b>(224,792)</b>          | (218,379)    | (192,591)    |
| Loss before contributed capital  | <b>(163,027)</b>          | (323,708)    | (96,913)     |
| Contributed capital  | <b>15,564</b>             | 38,982       | 57,137       |
| Change in net assets   | <b>(147,463)</b>          | (284,726)    | (39,776)     |
| Net assets, beginning of year  | <b>186,682</b>            | 471,408      | 511,184      |
| Net assets, end of year  | <b>\$ 39,219</b>          | \$ 186,682   | \$ 471,408   |

For fiscal year ended June 30, 2009, as compared to June 30, 2008, Net Assets decreased by \$147.5 million. The reduction in Net Assets was mainly due to a decrease of \$359 million in revenues caused principally by a decrease of 1,085.8 million of Kwh in the sales of energy, which represented \$59.6 million in basic rate revenues. In addition, revenues decreased due to a decline in the price per barrel of fuel of \$7.95 per barrel, which is billed to clients as a pass-through in their electric bills. Expenses decreased by \$541 million, mainly due to a reduction in the price of fuel, referred to above, and an adjustment to Other Pension Obligation Expenses resulting from the modification of health benefits to retired employees.

The Authority's management has taken the following expense control measures:

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Management's Discussion and Analysis (continued)

On June 30, 2009, the Authority changed the retired employees' health plan from a defined benefit plan to a defined contribution plan. This amendment to the health plan resulted in a net decrease of \$55 million in the accrued actuarial obligation of the Authority for the year ended June 30, 2009. Furthermore, the OPEB unfunded accrued actuarial liability was reduced from \$3.4 billion to \$531 million due to the change. For 2010 the annual required contribution will be \$27 million.

As of June 30, 2009, the Authority reduced 457 positions through voluntary retirement, ended contracts to temporary employees and eliminated 30 percent of seniors' staff positions. In addition, in January 2009 the Authority implemented a hiring freeze for all new staff.

The Authority's management has also identified the following strategies to stabilize the cost of energy:

- Revenue diversification - Net income generated from two recently created subsidiaries will be used to fund a revenue stabilization fund to reduce fuel price volatility.
- Fuel diversification – The Authority is in the process of evaluating generating units that use fuel oil to convert them to burn coal and natural gas.

For the fiscal year ended June 30, 2008, as compared to June 30, 2007, operating revenues and expenses increased by \$681.8 million (or 18.5%) and \$871.7 million (or 26.3%), respectively, resulting in a decrease in net assets of \$284.7 million. The decrease in net assets was mainly due to the recognition of the Other Postemployment Benefit (OPEB) expense of \$189.5 million. The Authority implemented Statement No. 45 of the Governmental Accounting Standard Board (GASB), *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*. GASB 45 establishes standards for the measurement, recognition of Other Postemployment Benefits (OPEB), related liabilities and disclosures. In addition, other reasons for the decrease in net assets were the decrease in sales of energy by 1,070 MhW (5.2%), representing \$52.3 million on basic rate revenues, and the increases on the total interest charge, net, and reserve for uncollectible accounts of \$16.1 million and \$20.1 million, respectively.

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Management's Discussion and Analysis (continued)

For the fiscal year ended June 30, 2007, as compared to June 30, 2006, operating revenues and expenses decreased by \$35.7 million (or 1%) and \$35.7 million (or 1%), respectively, resulting in a decrease in net assets of \$39.8 million. The decrease in net assets was mainly due to an increase in the reserve for uncollectible accounts of \$29.4 million and \$19.4 million related to the portion of the loss the Authority observed in connection of the Palo Seco Steam Plant fire, net of other operating income. The Authority holds a 30-day waiting period as a deductible on each occurrence in the extra expenses clause of Business Interruption Insurance Policy. The Authority assumed the cost of such retention instead of recovering it from the clients through the fuel and purchased power adjustment clauses. In addition, there was an increase on the total interest charge, net, of \$9.4 million for 2006-2007.

### **Capital Assets and Debt Administration**

#### **Capital Assets**

The Authority's investment in capital assets as of June 30, 2009, 2008 and 2007, amounts to approximately \$6,410 million, \$6,174 million and \$5,755 million (net of accumulated depreciation), respectively. This investment in capital assets includes land, generation, transmission and distribution systems, buildings, fixed equipment, furniture, fixtures and equipment. The total increases in the Authority's investment in capital assets (net of accumulated depreciation) were 3.8 percent, 7.3 percent and 5.8 percent for 2008-2009, 2007-2008 and 2006-2007, respectively.

A substantial portion of the capital expenditures for production plant in fiscal year ended June 30, 2009, 2008 and 2007, was spent on the rehabilitation and life extension of generating plants in order to achieve and maintain higher levels of availability, reliability and efficiency.

Major capital assets projects during fiscal years 2008 and 2009 included the following:

- The Authority replaced the two 44 MW San Juan Units No. 5 and 6, removed from service in fiscal year 1997, with 464 MW of combined-cycle capacity. The plant is comprised of two combined-cycle units, each consisting of one combustion turbine rated at 165 MW with a heat recovery steam generator (HRSG) feeding a single 67 MW steam turbine-generator.

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Management's Discussion and Analysis (continued)

- The Authority replaced the four 21 MW combustion turbines at Mayagüez with new four 55 MW dual fuel aero-derivative combustion turbines, which represent a net increase in capacity of approximately 136 MW over the replaced combustion turbines and they will generate electricity more efficiently. The first two combustion turbines were installed in fiscal year 2008 and the remainders two were installed and in service on fiscal year 2009.
- The Authority modified the eight 50 MW combustion turbines of Aguirre Combined Cycle Plant to enable them to burn either natural gas or light distillate. This conversion to dual fuel capability was completed on fiscal year 2009. The Authority is evaluating various alternatives to supply natural gas to the plant.
- The Authority is constructing a new 50-mile long 230 kV transmission line between its South Coast Steam Plant and the Transmission Center at Aguas Buenas. This new transmission line is expected to be operating in fiscal year 2012. Once in operation, this major infrastructure project will enhance the reliability of the transmission system, and will permit the increase of power transfers from the south coast of Puerto Rico to the northern and central regions.
- A second 230 kV line project is a new 38-mile long 230 kV transmission line connecting the South Coast Steam Plant and the Cambalache Plant at a cost of \$74 million. Currently, the line is scheduled for completion in fiscal year 2014.
- A program to improve the 38 kV sub-transmission systems is still in effect. This program includes the construction of underground 38 kV lines in Mayagüez, Carolina and San Juan. In addition, most 38 kV lines in the central part of the island are being replaced. These projects will improve the reliability of the sub-transmission system.
- The Authority constructed an underground 115 kV transmission circuit line around the San Juan metropolitan area in order to reduce the incidents of loss of power in the aftermath of hurricanes and other major storms, which strike Puerto Rico from time to time. The estimated cost for this project is \$195 million. The Federal Emergency Management Agency provided \$75 million for the investment in construction for this project through grants to the Authority.
- Other projects in the San Juan metropolitan area are new gas-insulated switchgear (GIS) 115/38 kV transmission centers at San Juan and Palo Seco Steam Plants, for \$63 million and \$65 million, respectively.

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Management's Discussion and Analysis (continued)

- In addition, major expansions to 115/38 kV transmission centers in Isla Grande at San Juan, Isabela, Hato Tejas at Bayamón, Canóvanas, Juncos and Las Cruces at Cidra will increase the power transfer and improve the voltage regulation of the 38 kV system under emergency conditions.
- The Authority repaired steam turbines generators and replaced transformers and major electrical equipments of Palo Seco Steam Plant unit, which have an 85 MW capacity. In addition, the Authority replaced the control room for all Palo Seco Steam Plant units and switch gear for Palo Seco Steam Plant units two, three and four. The total cost of repairing the Palo Seco Steam Plant units is of approximately \$118 million.

These projects are funded from cash reserves, excess-operating revenues, grants, and debt issued for such purposes.

Additional information on the Authority's capital assets can be found in Note 6 to the financial statements.

**Long-Term Debt**

At the end of the fiscal year 2009, 2008 and 2007, the Authority had total long-term debt outstanding of \$6,843.1 million, \$7,113.8 million and \$6,127.8 million, respectively, comprised of revenue bonds and other borrowings.

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

|  | 2009                | 2008         | 2007         |
|--|---------------------|--------------|--------------|
| Power revenue bonds, net                 | \$ 6,008,385        | \$ 6,162,987 | \$ 5,647,709 |
| Notes payable                            | 834,752             | 950,845      | 480,061      |
|  | <b>6,843,137</b>    | 7,113,832    | 6,127,770    |
| Current portion                          | <b>(1,067,310)</b>  | (598,296)    | (363,358)    |
| Long-term debt excluding current portion | <b>\$ 5,775,827</b> | \$ 6,515,536 | \$ 5,764,412 |

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Management's Discussion and Analysis (continued)

The Authority maintains ratings of "A3" by Moody's, and "BBB+" by S&P and A- by Fitch for its bonds.

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**

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. monetary and banking system, as well as within its territorial boundaries. The main drive of the Puerto Rico economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. In the second quarter of fiscal year 2009 U.S. Real GDP decreased at an annual rate of 1.0% after a 6.4% increase in the first quarter.

The preliminary estimate for the economy of Puerto Rico is expected to decrease in fiscal year 2010, at a rate of 5.5% in real terms, according to the latest forecast prepared by the Puerto Rico Planning Board (JP).

The Authority adopted the 2010 fiscal year budget on June 30, 2009. The total revenues for fiscal year 2009-2010 are projected to be approximately \$3,160.3 million. In addition, the Capital Improvement Program amounted to approximately \$350.0 million. The 2010 consolidated budget decreased by \$854.3 million (19.6 percent) when compared to the ammended consolidated budget approved on April 21, 2009 for fiscal year 2008-2009, due mainly to a decrease on projected fuel oil prices per barrel from \$73.75 for 2008-2009 to \$49.08 for 2009-2010, representing a 33.5 percent. In addition, the Capital Improvement Program decreased by \$96.0 million, representing a 21.5 percent.

**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  
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Balance Sheets

|   | <b>June 30</b>        |                     |
|---|-----------------------|---------------------|
|   | <b>2009</b>           | <b>2008</b>         |
|   | <i>(In thousands)</i> |                     |
| <b>Assets</b>   |                       |                     |
| Current assets:   |                       |                     |
| Cash and cash equivalents   | \$ 76,194             | \$ 40,920           |
| Receivables, net  | 1,018,796             | 1,171,112           |
| Fuel oil, at average cost   | 210,262               | 212,026             |
| Materials and supplies, at average cost   | 200,084               | 192,554             |
| Prepayments and other assets  | 2,177                 | 2,510               |
| Total current assets  | <u>1,507,513</u>      | <u>1,619,122</u>    |
| Other non-current receivables   | 108,061               | 101,734             |
| Restricted assets:  |                       |                     |
| Cash and cash equivalents held by trustee for<br>payment of principal and interest on bonds | 304,480               | 281,624             |
| Investments held by trustee   | 329,625               | 338,918             |
| Construction fund and other special funds   | 23,788                | 567,834             |
| Total restricted assets   | <u>657,893</u>        | <u>1,188,376</u>    |
| Utility plant:  |                       |                     |
| Plant in service  | 9,352,258             | 8,001,401           |
| Accumulated depreciation  | <u>(4,639,335)</u>    | <u>(4,383,884)</u>  |
|   | 4,712,923             | 3,617,517           |
| Construction in progress  | 1,697,250             | 2,556,476           |
| Total utility plant, net  | <u>6,410,173</u>      | <u>6,173,993</u>    |
| Deferred expenses:  |                       |                     |
| Unamortized debt issue costs  | 64,476                | 68,461              |
| Other   | 33,489                | 79,910              |
| Total deferred expenses   | <u>97,965</u>         | <u>148,371</u>      |
| Total assets  | <u>\$ 8,781,605</u>   | <u>\$ 9,231,596</u> |

*(Continue)*

|   | <b>June 30</b>        |                     |
|---|-----------------------|---------------------|
|   | <b>2009</b>           | <b>2008</b>         |
|   | <i>(In thousands)</i> |                     |
| <b>Liabilities and net assets</b>                             |                       |                     |
| Current liabilities:  |                       |                     |
| Notes payable   | \$ 595,374            | \$ 395,547          |
| Accounts payable and accrued liabilities                      | 820,851               | 854,882             |
| Customers' deposits   | 169,992               | 164,475             |
| Total current liabilities                                     | <b>1,586,217</b>      | 1,414,904           |
| Current liabilities payable from restricted assets:           |                       |                     |
| Current portion of long-term debt and bond anticipation notes | 853,040               | 584,203             |
| Notes payable from restricted assets                          | 11,622                | -                   |
| Accrued interest  | 148,910               | 137,497             |
| Other current liabilities payable from restricted assets      | 96,050                | 79,767              |
| Total current liabilities payable from restricted assets      | <b>1,109,622</b>      | 801,467             |
| Noncurrent liabilities:                                       |                       |                     |
| Long-term debt, excluding current portion                     | 5,775,827             | 6,515,536           |
| Sick leave benefits to be liquidated after one year           | 136,544               | 123,515             |
| Accrued unfunded other post-employment benefits liability     | 134,176               | 189,492             |
| Total noncurrent liabilities                                  | <b>6,046,547</b>      | 6,828,543           |
| Total liabilities   | <b>8,742,386</b>      | 9,044,914           |
| Net assets:   |                       |                     |
| Invested in utility plant, net of related debt                | 19,433                | 55,101              |
| Restricted for capital activity and debt service              | 233,208               | 307,666             |
| Unrestricted  | (213,422)             | (176,085)           |
| Total net assets  | <b>39,219</b>         | 186,682             |
| <br>  |                       |                     |
| Total liabilities and net assets                              | <b>\$ 8,781,605</b>   | <b>\$ 9,231,596</b> |

*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 Assets

|  | <b>Year Ended June 30</b> |                   |
|--|---------------------------|-------------------|
|  | <b>2009</b>               | <b>2008</b>       |
|  | <i>(In thousands)</i>     |                   |
| Operating revenues   | \$ 4,002,713              | \$ 4,362,209      |
| Operating expenses:  |                           |                   |
| Operations:  |                           |                   |
| Fuel   | 1,919,789                 | 2,303,036         |
| Purchased power  | 671,849                   | 661,097           |
| Claim for extra fuel expense   | -                         | (96,273)          |
| Other production   | 64,409                    | 58,035            |
| Transmission and distribution  | 168,102                   | 177,692           |
| Customer accounting and collection   | 111,337                   | 118,485           |
| Administrative and general   | 171,864                   | 415,185           |
| Maintenance  | 226,642                   | 248,569           |
| Depreciation   | 306,117                   | 295,317           |
| Total operating expenses   | <u>3,640,109</u>          | <u>4,181,143</u>  |
| Operating income   | 362,604                   | 181,066           |
| Interest income and other  | 25,326                    | 25,874            |
| Income before interest charges, contribution in lieu of taxes<br>and contributed capital | <u>387,930</u>            | <u>206,940</u>    |
| Interest charges:  |                           |                   |
| Interest on bonds  | 299,173                   | 271,016           |
| Interest on notes payable and other long-term debt                                       | 28,798                    | 44,291            |
| Other interest   | 2,819                     | 3,963             |
| Amortization of debt discount, issuance costs and refunding loss                         | 13,905                    | 14,124            |
| Allowance for funds used during construction   | (18,530)                  | (21,125)          |
| Total interest charges, net  | <u>326,165</u>            | <u>312,269</u>    |
| Income/(Loss) before contribution in lieu of taxes and contributed capital               | 61,765                    | (105,329)         |
| Contribution in lieu of taxes and other  | (224,792)                 | (218,379)         |
| Loss before contributed capital  | <u>(163,027)</u>          | <u>(323,708)</u>  |
| Contributed capital  | 15,564                    | 38,982            |
| Change in net assets   | <u>(147,463)</u>          | <u>(284,726)</u>  |
| Net assets, beginning balance  | 186,682                   | 471,408           |
| Net assets, ending balance   | <u>\$ 39,219</u>          | <u>\$ 186,682</u> |

*See accompanying notes.*

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

Statements of Cash Flows

|  | <b>Year Ended June 30</b> |                    |
|--|---------------------------|--------------------|
|  | <b>2009</b>               | <b>2008</b>        |
|  | <i>(In thousands)</i>     |                    |
| <b>Cash flows from operating activities</b>                        |                           |                    |
| Cash received from customers                                       | \$ 3,955,522              | \$ 4,095,297       |
| Cash paid to suppliers and employees                               | <b>(3,382,771)</b>        | <b>(3,981,056)</b> |
| Net cash flows provided by operating activities                    | <b>572,751</b>            | 114,241            |
| <b>Cash flows from noncapital financing activities</b>             |                           |                    |
| Proceeds from notes payable  | <b>195,000</b>            | 226,450            |
| Principal paid on notes payable                                    | <b>(247,821)</b>          | (62,277)           |
| Interest paid on notes payable                                     | <b>(12,716)</b>           | (18,754)           |
| Principal paid on fuel line of credit                              | –                         | 100,000            |
| Proceeds from fuel line of credit                                  | <b>50,000</b>             | (50,000)           |
| Interest paid on fuel line of credit                               | <b>(11,064)</b>           | (9,452)            |
| Net cash flows (used) provided for noncapital financing activities | <b>(26,601)</b>           | 185,967            |
| <b>Cash flows from capital and related financing activities</b>    |                           |                    |
| Construction expenditures  | <b>(527,161)</b>          | (673,207)          |
| Proceeds received from contributed capital                         | <b>12,661</b>             | 17,379             |
| Allowance for funds used during construction                       | <b>18,530</b>             | 21,125             |
| Power revenue bonds:   |                           |                    |
| Proceeds from issuance of bonds, net of original discount          | –                         | 706,199            |
| Principal paid on revenue bonds maturities                         | <b>(164,511)</b>          | (197,583)          |
| Interest paid on revenue bonds                                     | <b>(285,353)</b>          | (242,765)          |
| Proceeds from bond anticipation notes                              | <b>98,000</b>             | 215,229            |
| Payment of bond anticipation notes                                 | <b>(200,000)</b>          | –                  |
| Interest paid on notes payable                                     | <b>(18,820)</b>           | (23,189)           |
| Net cash flows used in capital and related financing activities    | <b>(1,066,654)</b>        | (176,812)          |
| <b>Cash flows from investing activities</b>                        |                           |                    |
| Purchases of investment securities                                 | <b>(1,512,316)</b>        | (1,180,735)        |
| Proceeds from sale and maturities of investment securities         | <b>1,539,206</b>          | 1,385,132          |
| Interest on investments  | <b>25,295</b>             | 35,856             |
| Transfer from restricted funds to general fund                     | <b>29,523</b>             | 25,438             |
| Transfer from general fund to restricted funds                     | <b>(15,000)</b>           | (5,000)            |
| Net cash flows provided by investing activities                    | <b>66,708</b>             | 260,691            |
| Net (decrease) increase in cash and cash equivalents               | <b>(453,796)</b>          | 384,087            |
| Cash and cash equivalents at beginning of year                     | <b>851,764</b>            | 467,677            |
| Cash and cash equivalents at end of year                           | <b>\$ 397,968</b>         | \$ 851,764         |

*(Continue)*

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

Statements of Cash Flows (continued)

|  | <b>Year Ended June 30</b> |                   |
|--|---------------------------|-------------------|
|  | <b>2009</b>               | <b>2008</b>       |
|  | <i>(In thousands)</i>     |                   |
| <b>Cash and cash equivalents</b>   |                           |                   |
| Unrestricted   | \$ 76,194                 | \$ 40,920         |
| Restricted:  |                           |                   |
| Cash and cash equivalents held by trustee for payment<br>of principal and interest on bonds      | 304,480                   | 281,624           |
| Cash and cash equivalents within construction<br>and other special funds                         | 17,294                    | 529,220           |
|  | <b>\$ 397,968</b>         | <b>\$ 851,764</b> |
| <br>   |                           |                   |
| <b>Reconciliation of net operating revenues to net cash<br/>provided by operating activities</b> |                           |                   |
| Operating income   | \$ 362,604                | \$ 181,066        |
| Adjustments to reconcile operating income to net cash<br>provided by operating activities:       |                           |                   |
| Depreciation   | 306,117                   | 295,317           |
| Amortization of asbestos removal   | -                         | 2,634             |
| Provision for uncollectible accounts and other   | 20,637                    | 30,021            |
| Changes in assets and liabilities:   |                           |                   |
| Receivables  | (118,391)                 | (582,615)         |
| Fuel oil   | 12,828                    | (55,442)          |
| Materials and supplies   | (7,517)                   | (30,350)          |
| Prepayments and other assets   | 333                       | 3,667             |
| Other deferred debits  | 50,659                    | (21,242)          |
| Noncurrent liabilities, excluding revenue bonds<br>and notes payable                             | (42,287)                  | 184,293           |
| Accounts payable and accrued liabilities   | (17,749)                  | 101,521           |
| Customer's deposits  | 5,517                     | 5,371             |
| Total adjustments  | <b>210,147</b>            | <b>(66,825)</b>   |
| Net cash flows provided by operating activities  | <b>\$ 572,751</b>         | <b>\$ 114,241</b> |

*See accompanying notes.*

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

Notes to Audited Financial Statements

June 30, 2009

**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 produces, transmits, and distributes, substantially, all of the electric power consumed in Puerto Rico.

The Authority has broad powers including, among others, to issue bonds for any of its corporate purposes. The Authority is required, under the terms of a Trust Agreement dated as of January 1, 1974, as amended (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 of Puerto Rico approved Act No. 189, which authorizes the Authority to create, acquire and maintain corporations, partnerships or subsidiary corporations, for profit or non-profit entities.

**Basis of Presentation – Blended Component Units**

The financial statements of the Authority include the financial position and operations of the Puerto Rico Irrigation Systems (Irrigation Systems) and PREPA Networks Corp. (PREPA.Net). The Irrigation Systems operate pursuant to the provisions of the Act, and Acts No. 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.

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

Notes to Audited Financial Statements (continued)

**1. Reporting Entity (continued)**

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

The Irrigations Systems and PREPA.Net conform to the requirements of Governmental Accounting Standards Board (GASB) 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 nongovernmental component units when they are included in a governmental financial reporting entity.

Condensed financial information as of June 30, 2009 and 2008 and for the years then ended for the Irrigation Systems is as follows:

|   | <b>2009</b>           | <b>2008</b> |
|---|-----------------------|-------------|
|   | <i>(In thousands)</i> |             |
| Balance sheets:   |                       |             |
| Assets:   |                       |             |
| Receivables, net  | <b>\$ 18,796</b>      | \$ 16,725   |
| Prepayments and other assets                                    | <b>2,186</b>          | 2,185       |
| Utility Plant, net of depreciation                              | <b>20,211</b>         | 19,376      |
| Total assets  | <b>\$ 41,193</b>      | \$ 38,286   |
| Liabilities:  |                       |             |
| Accounts payable, net   | <b>\$ 1,020</b>       | \$ 997      |
| Statements of revenues, expenditures and changes in net assets: |                       |             |
| Operating revenues  | <b>\$ 7,619</b>       | \$ 5,985    |
| Operating expenses  | <b>(4,735)</b>        | (3,949)     |
|   | <b>2,884</b>          | 2,036       |
| Net assets, beginning balance                                   | <b>37,289</b>         | 35,253      |
| Net assets, ending balance                                      | <b>\$ 40,173</b>      | \$ 37,289   |

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

Notes to Audited Financial Statements (continued)

**1. Reporting Entity (continued)**

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

PREPA.Net is a subsidiary of the Authority created to develop strategies for commercializing the surplus capacity of the installed Optical Fiber Network (OFN), adding flexibility and diversification to its operations. PREPA.Net was created on April, 2004 and started commercial operations during fiscal year 2005-2006.

PREPA.Net provides Optical Infrastructure to carriers, ISPs and enhanced services providers – with a highly reliable island wide fiber optic network.

PREPA.Net entered into a long-term lease with PREPA for the Indefeasible Right of Use (IRU) of all PREPA’s Optical Infrastructure. PREPA.Net’s network features state of the art optical technology that is being used by service providers to reach undersea cable landing stations, wireless network towers, and island wide locations.

In February 2008, PREPA.Net acquired Telecomunicaciones Ultramarinas de Puerto Rico (Ultracom). Ultracom is one of the three submarine cable station administrators in Puerto Rico. This acquisition provides PREPA.Net with International fiber optic capacity and satellite teleport facilities.

Condensed financial information as of June 30, 2009 and 2008 and for the years then ended for PREPA.Net is as follows:

|                                    | <b>2009</b>           | <b>2008</b> |
|------------------------------------|-----------------------|-------------|
|                                    | <i>(In thousands)</i> |             |
| Balance sheets:                    |                       |             |
| Assets:                            |                       |             |
| Cash and cash equivalents          | <b>\$ 10,421</b>      | \$ 8,737    |
| Receivables, net                   | <b>1,369</b>          | 1,116       |
| Prepayments and other assets       | <b>163</b>            | 130         |
| Utility plant, net of depreciation | <b>8,163</b>          | 8,660       |
| Total assets                       | <b>\$ 20,116</b>      | \$ 18,643   |
| Liabilities:                       |                       |             |
| Accounts payable, net              | <b>\$ 16,856</b>      | \$ 18,059   |

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

Notes to Audited Financial Statements (continued)

**1. Reporting Entity (continued)**

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

|   | 2009                  | 2008     |
|---|-----------------------|----------|
|   | <i>(In thousands)</i> |          |
| Statements of revenues, expenditures and changes in net assets: |                       |          |
| Operating revenues  | \$ 9,075              | \$ 5,678 |
| Operating expenses  | (6,399)               | (4,227)  |
|   | 2,676                 | 1,451    |
| Net assets, beginning balance                                   | 584                   | (867)    |
| Net assets, ending balance                                      | \$ 3,260              | \$ 584   |

**Reclassifications**

Certain prior year's amounts have been reclassified to conform to the current year's presentation.

**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.

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

Notes to Audited Financial Statements (continued)

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

**Basis of Accounting (continued)**

The Authority follows the provisions of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, as amended by GASB Statement No. 34, which requires proprietary activities to apply all applicable GASB pronouncements as well as all Financial Accounting Standards Board (FASB) Statements and Interpretations, and Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless the pronouncements conflict or contradict GASB pronouncements.

This pronouncement permits the adoption of all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict or contradict GASB pronouncements. The Authority, as allowed by GASB, decided not to implement any FASB Statement or Interpretation issued after November 30, 1989.

**GASB Statement No. 45**

During fiscal year 2008, the Authority adopted the provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions (OPEB)*. This Statement improves the relevance and usefulness of financial reporting by (a) requiring systematic, accrual-basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and (b) providing information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding the plan. Effects on the financial statements of the adoption of Statement No. 45 are disclosed in Note 12.

**Cash and Cash Equivalents**

For purposes of the statements of cash flows, 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.

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

Notes to Audited Financial Statements (continued)

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

**Receivables**

Receivables are stated net of estimated allowances for uncollectible accounts, which are determined based upon past collection experience and current economic conditions.

**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.

**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 balance sheet and the recording of changes in fair value in the statement of revenues, expenses and changes in net assets. The fair value is based on quoted market prices.

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.

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

Notes to Audited Financial Statements (continued)

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

**Investments (continued)**

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.

**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, 2009 and 2008 amounted to \$18.5 million and \$21.1 million, respectively. These amounts are net of interest income earned on investments amounting to \$4.1 million and \$375,117, 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.

**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 4.25% for 2009 and 2008.

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

Notes to Audited Financial Statements (continued)

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

**Unamortized Debt Issuance Expense**

Debt issuance expenses 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.

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.

**Pension Plan**

Pension expense is equal to the statutory required contribution to the employees' retirement system. A pension liability or asset is reported equal to the cumulative difference between annual required contributions and actual contributions.

**Other Postemployment Benefits**

Other Postemployment Benefits (OPEB) cost for healthcare provided to employees is measured and disclosed using the accrual basis of accounting (see Note 12).

**Accounting for Compensated Absences**

Accumulated unpaid vacation and sick leave pay are accrued when earned and an additional amount is accrued as a liability for the employer salary-related benefits associated with compensated absences using salary rates in effect at the balance sheets date.

The cost of compensated absences expected to be paid in the next twelve months is classified as current accounts payable and accrued liabilities while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

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

Notes to Audited Financial Statements (continued)

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

**Revenue Recognition, Fuel Costs and Purchase Power**

Clients are billed monthly, except for rural clients who are billed bi-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 as follows:

***Municipalities***

To the extent net revenues, as defined, are available, 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:

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.

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

Notes to Audited Financial Statements (continued)

**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 assets and reduce the related accounts receivable in the balance sheets.

**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.

**Interest-Rate Swap Agreements**

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 rate 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 are recorded as an adjustment to interest expense on the statements of income.

**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 monies held in these funds are presented as unrestricted cash and cash equivalents in the balance sheets.

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

Notes to Audited Financial Statements (continued)

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

At June 30, 2009 and 2008, 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):

|                       | 2009               |                   | 2008               |                   |
|-----------------------|--------------------|-------------------|--------------------|-------------------|
|                       | Carrying<br>Amount | Bank<br>Balance   | Carrying<br>Amount | Bank<br>Balance   |
| Unrestricted          | \$ 76,194          | \$ 76,578         | \$ 40,920          | \$ 47,464         |
| Restricted:           |                    |                   |                    |                   |
| Held by the Trustee   | 304,480            | 304,480           | 281,624            | 281,624           |
| Held by the Authority | 17,294             | 17,294            | 529,220            | 529,220           |
|                       | <b>\$ 397,968</b>  | <b>\$ 398,352</b> | <b>\$ 851,764</b>  | <b>\$ 858,308</b> |

**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 Authority's policy is to deposit funds with either institutions which provide insurance or securities as collateral. Such collateral is held by the Department of the Treasury of the Commonwealth, or with GDB, another component unit of the Commonwealth, which are uninsured and uncollateralized.

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.

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

Notes to Audited Financial Statements (continued)

**4. Accounts Receivable**

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

|   | <b>2009</b>         | <b>2008</b>  |
|---|---------------------|--------------|
| Electric and related services:  |                     |              |
| Government agencies and municipalities  | \$ <b>471,400</b>   | \$ 357,257   |
| Residential, industrial, and commercial                                       | <b>545,150</b>      | 611,773      |
| Recoveries under fuel adjustment clause under billed                          | <b>25,189</b>       | 5,487        |
| Unbilled services   | <b>150,742</b>      | 230,578      |
| Commonwealth subsidy (fuel adjustment clause) for certain residential clients | <b>18,980</b>       | 18,980       |
| Miscellaneous accounts and others   | <b>25,938</b>       | 22,021       |
|   | <b>1,237,399</b>    | 1,246,096    |
| Allowance for uncollectible accounts  | <b>(163,556)</b>    | (143,756)    |
|   | <b>1,073,843</b>    | 1,102,340    |
| Recovery from insurance companies and other                                   | <b>50,229</b>       | 167,733      |
| Accrued interest on investments   | <b>2,785</b>        | 2,773        |
| Less other non-current receivables, mostly related to the Commonwealth        | <b>(108,061)</b>    | (101,734)    |
|   | <b>\$ 1,018,796</b> | \$ 1,171,112 |

On October 29, 1991, the Authority entered into an agreement with the Commonwealth for the payment of the outstanding fuel adjustment subsidy receivable amounting to approximately \$94 million. Under this agreement, the Commonwealth was paying that amount over a fifteen-year period in installments of approximately \$6.3 million per year, without interest. As of June 30, 2004, the outstanding fuel adjustment subsidy receivable amounted to approximately \$31.6 million. In June 2004, the Legislature of the Commonwealth of Puerto Rico superseded the 1991 agreement with a revised agreement containing an eight-year payment schedule that totals \$55.7 million. The amount owed to the Authority under the 2004 agreement includes an allocation for past due government account receivables in addition to the unpaid balance of the fuel adjustment subsidy. As of June 30, 2009 and 2008, the outstanding receivable amounted to approximately \$18.9 million. This amount is included in other non-current receivables in the accompanying balance sheet.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**4. Accounts Receivable (continued)**

In addition, 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 portion of such receivables and other governmental receivables not expected to be collected during the next fiscal year are reflected in the accompanying balance sheets as other noncurrent receivables.

**5. Restricted Assets**

At June 30, 2009 and 2008, 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 2008-2009, as allowed by the Trust Agreement, the Authority withdrew \$29.5 million, which were accumulated in excess of the amount required.

*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. During fiscal year 2007-2008, the Authority withdrew \$29.5 million from 1974 Self-Insurance Fund to cover uninsured losses associated with the Palo Seco Steam Plant fires. In addition, the Authority deposited \$10 million and \$5 million to 1974 Self-Insurance Fund for fiscal years 2008-2009 and 2007-2008, respectively.

*Bond Service Account and Redemption Account (1974 Sinking Fund)* – Current year requirements for principal of and interest on Power Revenue Bonds. As of June 30, 2009 and 2008, cash and cash equivalents in this account amounted to \$304.5 million and \$281.6 million, respectively.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**5. Restricted Assets (continued)**

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

|                          | 2009              | 2008       |
|--------------------------|-------------------|------------|
| 1974 Reserve Account     | \$ 267,001        | \$ 287,832 |
| 1974 Self-Insurance Fund | <b>62,624</b>     | 51,086     |
|                          | <b>\$ 329,625</b> | \$ 338,918 |

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.

*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 of 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 withdrew \$67.7 million from 1974 Reserve Maintenance Fund to finance the recovery of the Palo Seco Steam Plant, which \$58.3 million was withdrawn during fiscal year 2007-2008. Such amount should be replenished following recommendations of the Consulting Engineers. During fiscal years 2008-2009 and 2007-2008 the Authority deposited \$5.0 million and \$9.7 million, respectively, to 1974 Reserve Maintenance Fund.

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Notes to Audited Financial Statements (continued)

**5. Restricted Assets (continued)**

At June 30, the 1974 Construction Fund and Reserve Maintenance Fund consist of (in thousands):

|                          | 2009                         |                 | 2008                         |             |
|--------------------------|------------------------------|-----------------|------------------------------|-------------|
|                          | Cash and Cash<br>Equivalents | Investments     | Cash and Cash<br>Equivalents | Investments |
| 1974 Construction Fund   | \$ 14,884                    | \$ 921          | \$ 529,220                   | \$ 38,045   |
| Reserve Maintenance Fund | -                            | 5,573           | -                            | 569         |
| Other Restricted Funds   | 2,410                        | -               | -                            | -           |
|                          | <b>\$ 17,294</b>             | <b>\$ 6,494</b> | \$ 529,220                   | \$ 38,614   |

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

|                             | 2009            | 2008             |
|-----------------------------|-----------------|------------------|
| U.S. Government obligations | \$ 921          | \$ 924           |
| Certificate of deposit      | 5,573           | 37,690           |
|                             | <b>\$ 6,494</b> | <b>\$ 38,614</b> |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**5. Restricted Assets (continued)**

**Investments**

The following table provides a summary of the Authority's investments by type at June 30, 2009 (in thousands):

| June 30, 2009   |               |                    |                        |                         |                      |
|---|---------------|--------------------|------------------------|-------------------------|----------------------|
|   | Coupon Rate   | Maturity Dates     | Face Value             | Fair Value              | % of Total Portfolio |
| <b>1974 Reserve Maintenance Fund</b>                          |               |                    |                        |                         |                      |
| Certificate of Deposits                                       | 0.18 to 0.21% | Jul-09             | \$ 5,573               | \$ 5,573                | 100.0%               |
|   |               |                    | <b>Total Portfolio</b> | <u>5,573</u>            |                      |
| <b>1974 Self Insurance Reserve Fund</b>                       |               |                    |                        |                         |                      |
| Federal Home Loan Mortgage Corp.                              | 2.0 to 5.05%  | 03/2012 to 06/2012 | 42,282                 | 42,472                  | 67.8%                |
| Federal Home Loan Bank  | 2.00%         | Jun-12             | 10,165                 | 10,146                  | 16.2%                |
| Certificates of Deposit                                       | 0.18 to 0.19% | Jul-09             | 10,006                 | 10,006                  | 16.0%                |
|   |               |                    | <b>Total Portfolio</b> | <u>62,624</u>           |                      |
| <b>1974 Reserve Account</b>                                   |               |                    |                        |                         |                      |
| Federal Home Loan Mortgage Corporation                        | 2.00%         | Oct-09             | 40,550                 | 40,474                  | 15.2%                |
| Federal Home Loan Bank  | 2.35 to 3.38% | 12/2011 to 12/2014 | 105,625                | 105,773                 | 3 9.6%               |
| Federal National Mortgage Association                         | 3.25%         | Feb-09             | 20,500                 | 20,535                  | 7.7%                 |
| Federal Farm Credit Bank                                      | 2.60 to 4.90% | 01/2013 to 05/2014 | 99,433                 | 99,559                  | 37.3%                |
| Certificates of Deposit                                       | 0.08 to 0.18% | Jul-09             | 660                    | 660                     | .2%                  |
|   |               |                    | <b>Total Portfolio</b> | <u>267,001</u>          |                      |
| <b>1974 Construction Fund</b>                                 |               |                    |                        |                         |                      |
| Other – Rural Electrification Administration (REA) Investment |               |                    | 921                    | 921                     | 100.0%               |
|   |               |                    | <b>Total Portfolio</b> | <u>921</u>              |                      |
|   |               |                    |                        | <u><u>\$336,119</u></u> |                      |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**5. Restricted Assets (continued)**

**Investments (continued)**

The following table provides a summary of the Authority's investments by type at June 30, 2008 (in thousands):

| June 30, 2008   |                 |                    |                        |                  |                      |
|---|-----------------|--------------------|------------------------|------------------|----------------------|
|   | Coupon Rate     | Maturity Dates     | Face Value             | Fair Value       | % of Total Portfolio |
| <b>1974 Reserve Maintenance Fund</b>                          |                 |                    |                        |                  |                      |
| Certificate of Deposits                                       | 1.35%           | 07/2008            | \$ 569                 | \$ 569           | 100.0%               |
|   |                 |                    | <b>Total Portfolio</b> | <b>569</b>       |                      |
| <b>1974 Self Insurance Reserve Fund</b>                       |                 |                    |                        |                  |                      |
| Federal Home Loan Mortgage Corp.                              | 3.60 to 5.05%   | 08/2010 to 02/2011 | 20,000                 | 20,359           | 39.9%                |
| Federal Home Loan Bank  | 3.13 to 3.38%   | 06/2010 to 05/2011 | 30,000                 | 30,068           | 58.8%                |
| Certificates of Deposit                                       | 2.050%          | 07/2008            | 659                    | 659              | 1.3%                 |
|   |                 |                    | <b>Total Portfolio</b> | <b>51,086</b>    |                      |
| <b>1974 Reserve Account</b>                                   |                 |                    |                        |                  |                      |
| Federal Home Loan Mortgage Corporation                        | 3.50 to 4.75%   | 11/2011 to 01/2013 | 60,000                 | 60,116           | 20.9%                |
| Federal Home Loan Bank  | 3.375 to 4.40%  | 07/2008 to 02/2012 | 51,410                 | 51,683           | 18.0%                |
| Federal National Mortgage Association                         | 3.125 to 5.085% | 06/2010 to 03/2013 | 100,000                | 100,903          | 35.1%                |
| Federal Farm Credit Bank                                      | 3.80 to 3.90%   | 03/2012 to 02/2013 | 40,000                 | 40,170           | 13.9%                |
| Certificates of Deposit                                       | 2.05 to 2.30%   | 07/2008            | 34,960                 | 34,960           | 12.1%                |
|   |                 |                    | <b>Total Portfolio</b> | <b>287,832</b>   |                      |
| <b>1974 Construction Fund</b>                                 |                 |                    |                        |                  |                      |
| Other – Rural Electrification Administration (REA) Investment |                 |                    | 924                    | 924              | 2.4%                 |
| Certificate of Deposit  | 3.00%           | 12/2008            | 37,121                 | 37,121           | 97.6%                |
|   |                 |                    | <b>Total Portfolio</b> | <b>38,045</b>    |                      |
|   |                 |                    |                        | <b>\$377,532</b> |                      |

**Puerto Rico Electric Power Authority**  
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**Notes to Audited Financial Statements (continued)**

**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.

As of June 30, 2009, 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 AAA by Standard & Poor's 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 June 30, 2009, 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.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**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. In accordance with the 1974 Trust Agreement, the Authority manages its exposure to declines in fair values by limiting the maturity of its investment portfolio up to 5 years. 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, 2009 and 2008 (in thousands):

| June 30, 2009              |            |                       |           |                   |
|----------------------------|------------|-----------------------|-----------|-------------------|
| Investment Type            | Fair Value | Investment Maturities |           | Total             |
|                            |            | Less than 1 year      | 1-5 years |                   |
| Federal Home Loan Mortgage | \$ 82,946  | \$ –                  | \$ 82,946 | \$ 82,946         |
| Federal Home Loan Bank     | 115,919    | –                     | 115,919   | 115,919           |
| Federal National Mortgage  | 20,535     | –                     | 20,535    | 20,535            |
| Federal Farm Credit Bank   | 99,559     | –                     | 99,559    | 99,559            |
| Certificate of Deposits    | 16,239     | 16,239                | –         | 16,239            |
| Other – REA Investment     | 921        | –                     | 921       | 921               |
| Total Investments          |            |                       |           | <u>\$ 336,119</u> |

| June 30, 2008              |            |                       |           |                   |
|----------------------------|------------|-----------------------|-----------|-------------------|
| Investment Type            | Fair Value | Investment Maturities |           | Total             |
|                            |            | Less than 1 year      | 1-5 years |                   |
| Federal Home Loan Mortgage | \$ 80,475  | \$ –                  | \$ 80,475 | \$ 80,475         |
| Federal Home Loan Bank     | 81,751     | 11,627                | 70,124    | 81,751            |
| Federal National Mortgage  | 100,903    | –                     | 100,903   | 100,903           |
| Federal Farm Credit Bank   | 40,170     | –                     | 40,170    | 40,170            |
| Certificate of Deposits    | 73,309     | 73,309                | –         | 73,309            |
| Other – REA Investment     | 924        | –                     | 924       | 924               |
|                            |            |                       |           | <u>\$ 377,532</u> |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**6. Utility Plant**

As of June 30, utility plant consists of:

|                               | <b>2009</b>           | <b>2008</b>  |
|-------------------------------|-----------------------|--------------|
|                               | <i>(In thousands)</i> |              |
| Distribution                  | <b>\$ 2,603,970</b>   | \$ 2,491,417 |
| Transmission                  | <b>1,387,017</b>      | 1,305,372    |
| Production                    | <b>2,295,224</b>      | 1,799,070    |
| Other production              | <b>1,173,550</b>      | 691,083      |
| Hydroelectric                 | <b>124,547</b>        | 107,593      |
| General                       | <b>1,726,617</b>      | 1,558,640    |
| Irrigation systems            | <b>33,170</b>         | 31,898       |
| Fiber Network                 | <b>8,163</b>          | 16,328       |
|                               | <b>9,352,258</b>      | 8,001,401    |
| Less accumulated depreciation | <b>(4,639,335)</b>    | (4,383,884)  |
|                               | <b>4,712,923</b>      | 3,617,517    |
| Construction in progress      | <b>1,697,250</b>      | 2,556,476    |
|                               | <b>\$ 6,410,173</b>   | \$ 6,173,993 |

Utility plant activity for the years ended June 30, 2009 and 2008 was as follows (in thousands):

|                               | <b>2008</b>                  |                  |                  |                  | <b>2009</b>               |
|-------------------------------|------------------------------|------------------|------------------|------------------|---------------------------|
|                               | <b>Beginning<br/>Balance</b> | <b>Increases</b> | <b>Decreases</b> | <b>Transfers</b> | <b>Ending<br/>Balance</b> |
| Utility plant                 | \$ 8,001,401                 | \$ –             | \$ (50,667)      | \$ 1,401,524     | <b>\$ 9,352,258</b>       |
| Construction work in progress | 2,556,476                    | 542,298          | –                | (1,401,524)      | <b>1,697,250</b>          |
| Total utility plant           | 10,557,877                   | 542,298          | (50,667)         | –                | <b>11,049,508</b>         |
| Less:                         |                              |                  |                  |                  |                           |
| Accumulated depreciation      | (4,383,884)                  | (306,118)        | 50,667           | –                | <b>(4,639,335)</b>        |
| Total utility plant, net      | \$ 6,173,993                 | \$ 236,180       | \$ –             | \$ –             | <b>\$ 6,410,173</b>       |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**6. Utility Plant (continued)**

|                               | <b>2007</b>                  |                  |                  |                  | <b>2008</b>               |
|-------------------------------|------------------------------|------------------|------------------|------------------|---------------------------|
|                               | <b>Beginning<br/>Balance</b> | <b>Increases</b> | <b>Decreases</b> | <b>Transfers</b> | <b>Ending<br/>Balance</b> |
| Utility plant                 | \$ 7,570,186                 | \$ –             | \$ (39,662)      | \$ 470,877       | \$ 8,001,401              |
| Construction work in progress | 2,312,611                    | 714,742          | –                | (470,877)        | 2,556,476                 |
| Total utility plant           | 9,882,797                    | 714,742          | (39,662)         | –                | 10,557,877                |
| Less:                         |                              |                  |                  |                  |                           |
| Accumulated depreciation      | (4,128,229)                  | (295,317)        | 39,662           | –                | (4,383,884)               |
| Total utility plant, net      | \$ 5,754,568                 | \$ 419,425       | \$ –             | \$ –             | \$ 6,173,993              |

Construction work-in-progress at June 30, 2009 and 2008 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, 2009, \$3,159 million of Power Revenue Bonds which remain outstanding are considered defeased.

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Notes to Audited Financial Statements (continued)

**8. Notes Payable**

The following is a summary of notes payable as of June 30, 2009:

|   | June 30, 2009    |                               |                        |                       |             |
|---|------------------|-------------------------------|------------------------|-----------------------|-------------|
|   | Maturity<br>Date | Effective<br>Interest<br>Rate | Current<br>Liabilities | Long-<br>Term<br>Debt | Total       |
| Notes payable, unrestricted:  |                  |                               |                        |                       |             |
| Revolving line of credit or \$275 million to finance fuel purchases   | Jun-2010         | 4.11% <sup>(V)</sup>          | \$ 275,000             | \$ –                  | \$ 275,000  |
| Line of credit of \$25 million to finance improvements of Isabela Irrigation System   | Jun-2010         | 4.60% <sup>(V)</sup>          | 6,104                  | –                     | 6,104       |
| Line of credit of \$100 million to be used in the recovery of Palo Seco Steam Plant (PSSP)  | Dec-2009         | 3.81% <sup>(V)</sup>          | 50,000                 | –                     | 50,000      |
| Line of credit of \$100 million to be used in the recovery of PSSP  | Jun-2010         | 3.63%                         | 50,000                 | –                     | 50,000      |
| Revolving line of credit of \$200 million for operational purposes  | Jun-2010         | 3.12% <sup>(V)</sup>          | 199,892                | –                     | 199,892     |
| Line of credit of \$64.2 million to fund payments required under a settlement agreement with municipalities   | Jun-2014         | 3.40% <sup>(V)</sup>          | 9,000                  | 39,058                | 48,058      |
| Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy | Nov-2013         | 4.30% <sup>(V)</sup>          | 5,378                  | 16,363                | 21,741      |
| Prepa.Net entered an agreement for a loan to be used on the acquisition of subsidiary, Ultramarinas de P.R. (ULTRACOM)  | Feb-2023         | 3.36% <sup>(V)</sup>          | –                      | 10,100                | 10,100      |
|   |                  |                               | 595,374                | 65,521                | 660,895     |
| Notes payable, restricted:  |                  |                               |                        |                       |             |
| Current portion of bond anticipation notes  |                  |                               |                        |                       |             |
| Revolving line of credit of \$400 million to finance various capital projects under Capital Improvement Program (CIP)   | Sep-2009         | 2.45% <sup>(V)</sup>          | 250,000                | –                     | 250,000     |
| Bridge loan of \$200 million to finance CIP   | Dec-2009         | 3.80% <sup>(V)</sup>          | 200,000                | –                     | 200,000     |
| Line of credit of \$96 million to finance CIP   | Jun-2011         | 4.75% <sup>(V)</sup>          | –                      | 48,000                | 48,000      |
| Line of credit of \$57 million to finance infrastructure in the municipalities  | Jun-2010         | 3.62% <sup>(V)</sup>          | 56,961                 | –                     | 56,961      |
|   |                  |                               | 506,961                | 48,000                | 554,961     |
| Other notes payable, restricted:  |                  |                               |                        |                       |             |
| Revolving line of credit of \$150 million to cover the cash collateral required by the Basis Swap Agreement   | Dec-2009         | 3.01% <sup>(V)</sup>          | 11,622                 | –                     | 11,622      |
|   |                  |                               | 11,622                 | –                     | 11,622      |
| Total notes payable   |                  |                               | \$ 1,113,957           | \$ 113,521            | \$1,227,478 |

(V) – variable interest rate

(F) – fixed interest rate

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**8. Notes Payable (continued)**

The following is a summary of notes payable as of June 30, 2008:

|   | <b>June 30, 2008</b> |                                |                            |                       |                     |
|---|----------------------|--------------------------------|----------------------------|-----------------------|---------------------|
|   | <b>Maturity Date</b> | <b>Effective Interest Rate</b> | <b>Current Liabilities</b> | <b>Long-Term Debt</b> | <b>Total</b>        |
| Notes payable unrestricted:   |                      |                                |                            |                       |                     |
| Revolving line of credit or \$225 million to finance fuel purchases   | Jun-2009             | 4.83% <sup>(V)</sup>           | \$ 225,000                 | \$ –                  | \$ 225,000          |
| Line of credit of \$25.3 million to finance the improvements of Isabela Irrigation System   | Jun-2009             | 4.35% <sup>(V)</sup>           | 6,104                      | –                     | 6,104               |
| Line of credit of \$100 million to be used in the recovery of Palo Seco Steam Plant (PSSP)  | Dec-2008             | 4.03% <sup>(V)</sup>           | 100,000                    | –                     | 100,000             |
| Line of credit of \$100 million to be used in the recovery of PSSP  | Jun-2009             | 3.70% <sup>(V)</sup>           | 50,000                     | –                     | 50,000              |
| Revolving line of credit of \$200 million for operational purposes  | Dec-2009             | 4.93% <sup>(V)</sup>           | –                          | 199,892               | 199,892             |
| Line of credit of \$64.2 million to fund payments required under a settlement agreement with the municipalities   | Jun-2014             | 5.22% <sup>(V)</sup>           | 8,900                      | 48,058                | 56,958              |
| Loan of \$41.5 to sale at discount the funds assigned by the Legislature of Puerto Rico through Joint Resolution 1290 of August 24, 2004, to pay the amount owed by the Commonwealth regarding the fuel subsidy | Nov-2013             | 4.20% <sup>(V)</sup>           | 5,193                      | 21,741                | 26,934              |
| Revolving line of credit of \$2 million for working capital purposes by PREPA.Net   |                      |                                | 350                        | –                     | 350                 |
| Prepa.Net entered an agreement for a loan to be used on the acquisition of subsidiary, Ultramarinas de P.R. (ULTRACOM)  | Feb-2023             | 3.36 % <sup>(V)</sup>          | –                          | 10,100                | 10,100              |
|   |                      |                                | <u>395,547</u>             | <u>279,791</u>        | <u>675,338</u>      |
| Notes payable, restricted:  |                      |                                |                            |                       |                     |
| Current portion of Bond anticipation notes  |                      |                                |                            |                       |                     |
| Revolving line of credit of \$400 million to finance various capital projects under Capital Improvement Program (CIP)   | Sep-2009             | 4.00% <sup>(V)</sup>           | –                          | 400,000               | 400,000             |
| Bridge loan of \$200 million to finance CIP   | Jun-2009             | 5.16% <sup>(V)</sup>           | 200,000                    | –                     | 200,000             |
| Line of credit of \$57 million to finance the infrastructure in the municipalities  | Jun-2009             | 5.57% <sup>(V)</sup>           | 56,961                     | –                     | 56,961              |
|   |                      |                                | <u>256,961</u>             | <u>400,000</u>        | <u>656,961</u>      |
| Total notes payable   |                      |                                | <u>\$ 652,508</u>          | <u>\$ 679,791</u>     | <u>\$ 1,332,299</u> |

(V) – variable interest rate

(F) – fixed interest rate

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**8. Notes Payable (continued)**

Short-term debt activity for the years ended June 30, 2009 and 2008 was as follows:

|  | <b>2009</b>           | <b>2008</b>       |
|--|-----------------------|-------------------|
|  | <i>(In thousands)</i> |                   |
| Balance at beginning of year               | \$ 652,508            | \$ 436,766        |
| Proceeds and transfers from long-term debt | 709,270               | 329,672           |
| Payment of short-term debt                 | (247,821)             | (113,930)         |
| Balance at end of year                     | <b>\$ 1,113,957</b>   | <b>\$ 652,508</b> |
| Notes payable – short-term:                |                       |                   |
| Unrestricted                               | \$ 595,374            | \$ 395,547        |
| Restricted                                 | 518,583               | 256,961           |
| Total of notes payable                     | <b>\$ 1,113,957</b>   | <b>\$ 652,508</b> |

**9. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities for the years ended June 30, 2009 and 2008 was as follows:

|  | <b>2009</b>           | <b>2008</b>       |
|--|-----------------------|-------------------|
|  | <i>(In thousands)</i> |                   |
| Accounts payable, accruals, and withholdings in process of payment   | \$ 537,200            | \$ 630,960        |
| Additional accruals and withholdings:  |                       |                   |
| Injuries and damages and other   | 23,210                | 22,373            |
| Accrued vacation and payroll benefits  | 57,374                | 57,396            |
| Accrued sick leave and payroll benefits - exclusive of benefits to be liquidated after one year of approximately \$136.5 million in 2009 and \$123.5 in 2008 | 25,749                | 32,111            |
| Accrued compensation   | 27,294                | 24,240            |
| Accrued pension plan contribution and withholding from employees:  |                       |                   |
| Employees' Retirement System   | 15,154                | 13,432            |
| Employees health plan  | 21,803                | 20,125            |
| Contribution in lieu of taxes  | 100,462               | 40,613            |
| Other accrued liabilities  | 12,605                | 13,632            |
|  | <b>\$ 820,851</b>     | <b>\$ 854,882</b> |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**10. Other Current Liabilities Payable from Restricted Assets**

|                    | <b>2009</b>           | <b>2008</b> |
|--------------------|-----------------------|-------------|
|                    | <i>(In thousands)</i> |             |
| Contract retainage | \$ <b>20,794</b>      | \$ 26,642   |
| Other liabilities  | <b>75,256</b>         | 53,125      |
|                    | <b>\$ 96,050</b>      | \$ 79,767   |

**11. Long-Term Debt**

At June 30, long-term debt consists of:

|  | <b>2009</b>           | <b>2008</b>  |
|--|-----------------------|--------------|
|  | <i>(In thousands)</i> |              |
| Power Revenue Bonds payable:   |                       |              |
| Publicly offered at various dates from 1992 to 2005,<br>interest rates ranging from 3.2% to 6.25%, maturing<br>to 2038 | <b>\$ 6,004,060</b>   | \$ 6,167,780 |
| Rural Utility Services (RUS) issues - interest rate of 5%,<br>maturing through 2028                                    | <b>26,631</b>         | 27,422       |
|  | <b>6,030,691</b>      | 6,195,202    |
| Less unamortized discount and debt reacquisition costs   | <b>(22,306)</b>       | (32,215)     |
| Revenue bonds payable, net   | <b>6,008,385</b>      | 6,162,987    |
| Notes payable and bond anticipation notes  | <b>834,752</b>        | 950,845      |
|  | <b>6,843,137</b>      | \$ 7,113,832 |
| Less current portion of long-term debt:  |                       |              |
| Notes payable from unrestricted assets   | <b>214,270</b>        | 14,093       |
| Notes payable and bond anticipation notes from<br>restricted assets  | <b>506,961</b>        | 256,961      |
| Power revenue bonds  | <b>346,079</b>        | 327,242      |
| Current portion of long term debt from restricted assets   | <b>853,040</b>        | 584,203      |
| Total current portion of long-term debt  | <b>1,067,310</b>      | \$ 598,296   |
|  | <b>\$ 5,775,827</b>   | \$ 6,515,536 |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

Long-term debt activity for the years ended June 30, 2009 and 2008 was as follows:

|  | <b>2009</b>           | <b>2008</b>  |
|--|-----------------------|--------------|
|  | <i>(In thousands)</i> |              |
| Long-term debt excluding current portion                     | <b>\$ 7,113,832</b>   | \$ 6,369,502 |
| New issues:  |                       |              |
| Power revenue bonds  | –                     | 697,345      |
| Debt discount on new bond issues – net                       | –                     | 4,905        |
| Notes payable  | <b>98,000</b>         | 241,329      |
|  | <b>7,211,832</b>      | 7,313,081    |
| Payments:  |                       |              |
| Power revenue bond – July 1                                  | <b>(164,111)</b>      | (197,202)    |
| Power revenue bond – January 1                               | <b>(400)</b>          | (381)        |
| Notes payable  | <b>(214,093)</b>      | (12,277)     |
| Total payments   | <b>(378,604)</b>      | (209,860)    |
| Amortization of debt discount and excess reacquisition costs | <b>9,909</b>          | 10,611       |
| Balance at end of year                                       | <b>\$ 6,843,137</b>   | \$ 7,113,832 |
| Total current portion of long-term debt                      | <b>\$ 1,067,310</b>   | \$ 598,296   |

**Power Revenue Bonds Payable**

During fiscal year 2008, the Authority issued its Power Revenue Bonds, Series WW for the purpose of paying a portion of the cost of its Capital Improvements Program (CIP).

A summary of the net proceeds of the Power Revenue Bonds, Series WW and application of the proceeds follows:

|                               |                       |
|-------------------------------|-----------------------|
| Principal amount of the Bonds | \$ 697,345,000        |
| Plus:                         |                       |
| Net original issue premium    | 8,853,673             |
| Proceeds                      | <b>\$ 706,198,673</b> |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Power Revenue Bonds Payable (continued)**

|   |                              |
|---|------------------------------|
| Application of net proceeds:  |                              |
| Deposit to 1974 Construction Fund   | \$ 650,004,640               |
| Capitalized interest on Bonds through July 1, 2009                                  | 37,120,672                   |
| Underwriting discount and estimated legal, printing<br>and other financing expenses | <u>19,073,361</u>            |
| Application of proceeds   | <u><u>\$ 706,198,673</u></u> |

Maturities of the Power Revenue Refunding Bonds Series WW issued during fiscal year 2008 range from July 1, 2010 to July 1, 2038. The Series WW Bonds bear fixed interest rates ranging from 5% to 5.5%. Interest on the Series WW Bonds is payable on each January 1 and July 1.

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.

Gross revenues, exclusive of income on certain investments, less current expenses as defined in the 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 usually are retired with the proceeds of long-term debt.

**Interest-Rate Swap Agreements**

To protect against the potential of rising interest rates, the Authority entered into quarterly separate pay-fixed, receive-variable interest-rate swaps at a cost anticipated to be less than what the Authority would have paid to issue fixed-rate debt.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Interest-Rate Swap Agreements (continued)**

The terms, fair values and credit ratings of the outstanding swaps as of June 30, 2009, were as follows:

| Associated Power<br>Revenue Bonds | Notional<br>Amount    | Effective<br>Date | Maturity<br>Date | Fixed<br>Rate | Fair<br>Value          |
|-----------------------------------|-----------------------|-------------------|------------------|---------------|------------------------|
| LIBOR Bonds, Series UU            | \$ 169,531,850        | May 3, 2007       | July 2, 2029     | 4.080%        | \$ (19,008,841)        |
| LIBOR Bonds, Series UU            | 123,762,250           | May 3, 2007       | July 1, 2025     | 4.232%        | (12,401,403)           |
| LIBOR Bonds, Series UU            | 225,597,150           | May 3, 2007       | July 1, 2031     | 4.286%        | (27,326,155)           |
| LIBOR Bonds, Series UU            | 61,107,750            | May 3, 2007       | July 1, 2025     | 4.232%        | (6,579,534)            |
| LIBOR Bonds, Series UU            | 83,343,150            | May 3, 2007       | July 2, 2029     | 4.080%        | (9,996,186)            |
| LIBOR Bonds, Series UU            | 111,092,850           | May 3, 2007       | July 1, 2031     | 4.286%        | (14,295,628)           |
| Muni-BMS Bonds, Series UU         | 25,525,000            | May 3, 2007       | July 3, 2017     | 4.014%        | (404,845)              |
| Muni-BMS Bonds, Series UU         | 17,000,000            | May 3, 2007       | July 2, 2018     | 4.054%        | (266,327)              |
| Muni-BMS Bonds, Series UU         | 29,055,000            | May 3, 2007       | July 1, 2020     | 4.124%        | (448,647)              |
| Total                             | <u>\$ 846,015,000</u> |                   |                  |               | <u>\$ (90,727,566)</u> |

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

During fiscal years 2008-2009, and 2007-2008 the payments of fixed rate interest from the Authority exceeded the amount received as variable interest rate from swap counter parties by \$16.6 million and \$4.8 million, respectively.

Using rates as of June 30, 2009, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. These debt service requirements are included in the scheduled maturities of long-term debt disclosed further on this note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Interest-Rate Swap Agreements (continued)**

| Fiscal Year<br>Ending June 30 | Principal             | Interest              | Interest Rate<br>Swap, Net | Total                 |
|-------------------------------|-----------------------|-----------------------|----------------------------|-----------------------|
| 2010                          | \$ —                  | \$ 12,650,917         | \$ 22,832,597              | \$ 35,483,514         |
| 2011                          | —                     | 12,650,917            | 22,832,597                 | 35,483,514            |
| 2012                          | —                     | 12,650,917            | 22,832,597                 | 35,483,514            |
| 2013                          | —                     | 12,650,917            | 22,832,597                 | 35,483,514            |
| 2014                          | —                     | 12,650,917            | 22,832,597                 | 35,483,514            |
| 2015-2031                     | 846,015,000           | 173,554,557           | 325,604,509                | 499,159,066           |
| Total                         | <u>\$ 846,015,000</u> | <u>\$ 236,809,142</u> | <u>\$ 439,767,494</u>      | <u>\$ 676,576,636</u> |

As of June 30, 2009, the swaps had a negative fair value of approximately \$90.7 million. The negative fair value of the swaps may be countered by reduction in future net interest payments required on the variable-rate Power Revenue Bonds, creating higher synthetic rates.

As of June 30, 2009, the Authority was not exposed to credit risk because the swaps had a negative fair value in the amount of the swaps' 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 Aa1 and Aa3 as issued by Moody's Investor Services (Moody's), AA- and A+ by Standard & Poors (S&P), and AA- and A+ by Fitch Ratings.

The derivative contract uses the International Swaps and Derivatives Association, Inc. master agreement, which includes standard termination events, such as failure to pay 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 issued 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.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Forward Swap Agreements**

On September 5, 2007, the Authority entered into two forward floating-to-fixed interest-rate swap transaction relating to the bonds (Forward Swap Agreement) with UBS AG and Goldman Sachs Capital Markets for two thirds and one third, respectively, of a notional amount of \$600 million in Power Revenue Bonds to be issued by the Authority. The transaction was set to expire on September 1, 2008 or the date before the bonds would be issued, if earlier than September 1, 2008. The transactions fixed rate was established a 3.652 percent per annum.

On June 26, 2008, the Authority paid to the aggregate amount of \$13.5 million to the counterparties to terminate the Forward Swap Agreement with the proceeds of Power Revenue Bonds, Series WW.

**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 a 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.

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 Government Development Bank for Puerto Rico ("GDB"), its fiscal agent.

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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Basis Swap Agreement (continued)**

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.

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 the fiscal year 2008-2009, the Authority received from its counterparty \$7.9 million. 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.

|                              | <u>2008-2009</u>    |
|------------------------------|---------------------|
| Basis annuity received       | \$ 6,419,875        |
| LIBOR index amounts received | 20,662,060          |
| SIFMA index amounts paid     | <u>(19,178,536)</u> |
| Net amount received          | <u>\$ 7,903,399</u> |

As of June 30, 2009, the 2008 basis swap had a negative fair value to the Authority of approximately \$61.3 million. The negative fair value of the basis swap may be view as a reduction in future benefits to be received from the counterparty.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**11. Long-Term Debt (continued)**

**Basis Swap Agreement (continued)**

According to the Credit Support Annex of the Master Swap Agreement, if the fair value of the 2008 basis swap is negative and exceeds the threshold amount, the Authority shall post eligible collateral on the next business day upon notification from its counterparty. During fiscal year 2008-2009 the threshold amount for the Authority was \$50.0 million. The Authority and GDB entered into an agreement for a \$150 million revolving line of credit to meet collateral posting requirements from the 2008 basis swap. As of June 30, 2009, \$11.6 million of this line of credit was outstanding.

**Scheduled Maturities of Long-Term Debt**

The scheduled maturities of long-term debt with interest thereon at June 30, 2009, are as follows:

| Fiscal Year Ending June 30,  | Principal    | Interest              | Total        |
|--|--------------|-----------------------|--------------|
|  |              | <i>(In thousands)</i> |              |
| 2010   | \$ 1,075,595 | \$ 443,533            | \$ 1,519,128 |
| 2011   | 241,740      | 284,592               | 526,332      |
| 2012   | 207,016      | 273,107               | 480,123      |
| 2013   | 230,071      | 263,058               | 493,129      |
| 2014   | 236,329      | 251,922               | 488,251      |
| 2015-2019  | 1,155,091    | 1,083,399             | 2,241,575    |
| 2020-2024  | 1,336,076    | 780,630               | 2,113,621    |
| 2025-2029  | 1,197,530    | 466,799               | 1,664,329    |
| 2030-2034  | 838,585      | 207,937               | 1,046,522    |
| 2035-2038  | 347,410      | 39,826                | 387,236      |
| Total  | 6,865,443    | 4,094,803             | 10,960,246   |
| Less:  |              |                       |              |
| Unamortized discount and premium   | 186,225      | —                     | 186,225      |
| Excess reacquisition costs   | (208,531)    | —                     | (208,531)    |
| Interest   | —            | (4,094,803)           | (4,094,803)  |
| Total long-term debt   | 6,843,137    |                       | 6,843,137    |
| Current portion of notes payable   | (214,270)    | —                     | (214,270)    |
| Current portion, net of discount and excess reacquisition costs of bonds | (346,079)    | —                     | (346,079)    |
| Current portion of notes payable from restricted assets                  | (506,961)    | —                     | (506,961)    |
| Current portion of long-term debt from restricted assets                 | (853,040)    | —                     | (853,040)    |
| Total current portion  | (1,067,310)  | —                     | (1,067,310)  |
| Long-term debt, excluding current portion                                | \$ 5,775,827 | \$ —                  | \$ 5,775,827 |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

## 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; also, reduced benefits are 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, 2007 and projected to June 30, 2009, based on current year demographic data.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

**Supplemental Benefits not Funded Through the System**

Supplemental benefits were unfunded and such benefits were reimbursed to the System when paid up to 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.

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 and/or be paid in cash the value of such sick leave upon separation from employment.

The Authority's annual pension cost for the year ended June 30, 2009 and related information for the Plan and supplemental benefits follows:

|   | <u>Pension Plan</u>  |
|---|--|
| Contribution rates:                         |  |
| Authority                                   | 21.08%   |
| Plan members                                | 10.10%   |
| Annual pension cost (thousands)             | \$78,844   |
| Contributions made and accruals (thousands) | \$78,555   |
| Actuarial valuation date                    | 6/30/2007  |
| Actuarial cost method                       | Entry age  |
| Amortization method                         | Level percentage of pay, closed<br>(4% payroll increases per year) |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

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

Supplemental Pension Obligations Exchanged for Forfeited Sick Leave Benefits (continued)

|   | <b>Pension Plan</b>  |
|---|--|
| Remaining amortization period                               | 29 years   |
| Asset valuation method                                      | 3-year smoothed market   |
| Actuarial assumptions:                                      |  |
| Investment rate of return (net of administrative expenses)* | 8.5%   |
| Projected salary increases*                                 | 5%   |
| *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. |

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Notes to Audited Financial Statements (continued)

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

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

Supplemental Pension Obligations Exchanged for Forfeited Sick Leave Benefits (continued)

| <b>Trend Information</b>  |                                  |                                      |                               |
|---------------------------|----------------------------------|--------------------------------------|-------------------------------|
| <i>(In millions)</i>      |                                  |                                      |                               |
| <b>Fiscal Year Ending</b> | <b>Annual Pension Cost (APC)</b> | <b>Percentage of APC Contributed</b> | <b>Net Pension Obligation</b> |
| Pension Plan:             |                                  |                                      |                               |
| 06/30/01                  | 35                               | 100%                                 | 0.0                           |
| 06/30/02                  | 43                               | 100%                                 | 0.0                           |
| 06/30/03                  | 50.6                             | 100%                                 | 0.0                           |
| 06/30/04                  | 65                               | 81%                                  | 12.3                          |
| 06/30/05                  | 69.9                             | 100%                                 | 12.6                          |
| 06/30/06                  | 74.8                             | 100%                                 | 12.9                          |
| 06/30/07                  | 74.6                             | 100%                                 | 13.2                          |
| 06/30/08                  | 76.3                             | 100%                                 | 13.5                          |
| 06/30/09                  | 78.8                             | 100%                                 | 13.8                          |

The annual required contribution amounted to \$78.6 million in 2009 and \$76.0 million in 2008. The net pension obligation is included in accounts payable and accrued liabilities on the balance sheet.

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

Postemployment Health Plan

*Plan Description* – PREPA Retired Employees Healthcare Plan (Health Plan) is a single-employer defined contribution benefit healthcare plan administered by the Authority. During the fiscal year 2008-2009, 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.

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Notes to Audited Financial Statements (continued)

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

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

Postemployment Health Plan (continued)

*Membership* – During the fiscal year 2008-2009, 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, their legal spouses, and certain disabled dependents 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.

*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 of the employer (ARC), 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 the fiscal year 2008-2009 and 2007-2008. (in thousands):

|                                   |            |              |
|-----------------------------------|------------|--------------|
| Annual OPEB cost (or ARC)         | \$ 24,363  | \$ 259,266   |
| Actuarial Accrued Liability (AAL) | \$ 531,054 | \$ 3,375,046 |
| Unfunded AAL                      | \$ 531,054 | \$ 3,375,046 |
| Funded Ratio                      | 0%         | 0%           |
| Annual Covered Payroll            | \$ 348,929 | \$ 349,183   |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

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

Postemployment Health Plan (continued)

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

|   |                   |
|---|-------------------|
| Change in net OPEB obligation:  |                   |
| Net OPEB obligation, June 30, 2008  | \$ 189,492        |
| Total annual required contribution (ARC), July 1, 2008 –<br>June 30, 2009 | 25,626            |
| Actual benefit payments, July 1, 2008 – June 30, 2009                     | (80,942)          |
| Net OPEB obligation, June 30, 2009  | <u>\$ 134,176</u> |

The net OPEB obligation is recorded as a component of compensated absences and postemployment benefits in the accompanying balance sheet as of June 30, 2009 and 2008.

For the fiscal year ended June 30, 2009, the Authority's annual OPEB expense was (\$55.3) million, which reduced the accrued unfunded OPEB liability. This was due to changes in the Postemployment Health Plan benefits to retirees effective June 30, 2009. This is included in Administrative and General Expenses.

Major changes to the Health Plan during 2008-2009 were as follows:

1. All future retirees on or after September 1, 2009 to have 30 years of service to received health benefits.
2. Health benefits for all current and future retirees will be applied at \$300 per member per month per retirees and spouses under age 65 and \$200 per member per month for retirees and spouses over age 65 and over.

The OPEB expense is not equal to the Annual Required Contribution, which is \$25.6 million. The OPEB expense is considered in operating expenses in the Authority's Statement of Revenues, Expenses and Changes in Net assets. The actual payment to the health plan for retirees and their beneficiaries, which totaled \$80.9 million, is included in Administrative and General Expenses.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

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

Postemployment Health Plan (continued)

For the fiscal year ended June 30, 2008, the Authority's annual OPEB expense of \$189.5 million was not equal to the Annual Required Contribution, which was \$259.3 million. The payment to the health plan for retirees and their beneficiaries, which totaled \$69.8 million for fiscal year 2008, is included in Administrative and General Expenses.

*OPEB Actuarial Valuation* – The Authority's other Post-Employment Benefits Program actuarial valuation was conducted by Buck Consultants, LLC and Cavanaugh Macdonald Consulting, LLC for fiscal year 2008 and 2009, respectively. Both are members 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             | June 30, 2007                              | June 30, 2006   |
|--------------------------------------|--|---|
| Actuarial Cost Method                | Projected Unit Credit                      | Projected Unit Credit   |
| Amortization method                  | Level Dollar Amortization<br>over 30 years | Level Dollar Amortization<br>over 30 years                    |
| Remaining Amortization<br>Period     | 28 years                                   | 29 years  |
| Actuarial Assets Valuation<br>Method | Not applicable                             | Not applicable  |
| Investment Rate of Return            | 4% (includes inflation rate)               | 4% (unfunded rate)  |
| Inflation Rate:                      | 3%   |   |
| Medical                              | Not applicable                             | Start at 9% decreasing by<br>1% to an ultimate rate of<br>5%  |
| Prescription drug                    | Not applicable                             | Start at 10% decreasing by<br>1% to an ultimate rate of<br>5% |
| Dental                               | Not applicable                             | Fixed 4%  |
| Projected Salary Increases           | 4%   | 4%  |

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

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

Postemployment Health Plan (continued)

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:

|   | <u>2009</u>              | <u>2008</u>              |
|---|--------------------------|--------------------------|
|   | <i>(In thousands)</i>    |                          |
| Governmental sector, principally instrumentalities, agencies<br>and corporations of the Commonwealth of Puerto Rico | <b>\$ 497,951</b>        | \$ 505,991               |
| Municipalities of the Commonwealth of Puerto Rico   | <b>187,686</b>           | 187,365                  |
|   | <b><u>\$ 685,637</u></b> | <b><u>\$ 693,356</u></b> |

**14. Net Assets**

Restricted assets at June 30, 2009 and 2008 include \$233.2 million and \$307.7 million, respectively, which have been appropriated principally to comply with long-term principal and interest debt services requirements and a reserve for damaged or destroyed property of the Authority not fully covered by insurance as required by the 1974 Agreement. Funds set aside for self-insurance purposes are deposited in the Self-Insurance Fund held by the Trustee (see Note 5).

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**15. Claim for Extra Fuel Expense**

The Authority expects insurance companies to cover higher fuel price and other costs associated with alternate generation capacity in connection with two fires on the Authority's generating units. In years preceding and up to June 30, 2009, there were \$334 million in claims to insurance companies due to these fires. \$283 million has been collected up to June 30, 2009 and \$51 million was outstanding as of June 30, 2009. Subsequent to June 30, 2009, the Authority has received \$17 million of the outstanding amount. During the year ended June 30, 2009 there were no additional claims related to extra fuel expense.

**16. Contribution in Lieu of Taxes**

|  | <b>2009</b>           | <b>2008</b> |
|--|-----------------------|-------------|
|  | <i>(In thousands)</i> |             |
| Municipalities   | <b>\$ 187,686</b>     | \$ 187,365  |
| Commonwealth:  |                       |             |
| Hotels   | <b>6,508</b>          | 6,689       |
| Fuel adjustment subsidy  | <b>30,579</b>         | 24,299      |
| Other subsidies (offset against outstanding<br>accounts receivable and reimbursable costs) | <b>19</b>             | 26          |
|  | <b>\$ 224,792</b>     | \$ 218,379  |

**17. Commitments and Contingencies**

**Environmental Matters**

Facilities and operations of the Authority are subject to regulations 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) performed an inspection of various facilities of the Authority and became aware of deficiencies in different areas, principally air opacity; water quality; spill prevention control and countermeasures; and underground storage tanks.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

**Environmental Matters (continued)**

The Authority and EPA undertook negotiations 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 EPA reached an agreement that resulted in a Consent Decree approved by the United States District Court for the District of Puerto Rico on March 19, 1999. In the Consent Decree, the Authority agreed to pay a civil penalty of \$1.5 million, which has already been paid, and to implement environmental supplemental projects amounting to \$4.5 million, which have already been funded to the full extent required by the Consent Decree. In addition, the Consent Decree requires that the Authority improves and implements compliance programs and operations in order to assure compliance with environmental laws and regulations.

Since the Consent Decree became effective, several Notices of Dispute Resolution were filed with the United States District Court for the District of Puerto Rico to contest EPA's interpretation of the applicable method to determine visible emission from the generating units, EPA's determination that the Costa Sur power plant was a repetitious violator of the visible emission requirements of the Consent Decree, and several other notices of violation issued by EPA regarding the applicable method to determine visible emission.

The parties reached an agreement to settle such Notices and lodged a Consent Decree Modification at the United States District Court for the District of Puerto Rico on June 24, 2004. A major program within the agreement was the reduction in two steps of the sulfur content in No. 6 fuel oil at the Authority's southbound power plants to 0.75% or less by March 1, 2005 and to 0.50% or less by March 1, 2007. Currently, the requirements under this program have been fulfilled. The Authority believes that the agreement enables the Authority to take additional measures that will enhance its ability to comply with the Consent Decree.

In general, the Authority is consistently achieving a level of compliance with in-stack opacity requirements and the Clean Water Act regulations equal or greater of 99%. Also, as of today the Authority had finished with the requirements of the Spill Prevention, Control and Countermeasures regulation under the Consent Decree.

**Puerto Rico Electric Power Authority**  
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**Notes to Audited Financial Statements (continued)**

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

**Environmental Matters (continued)**

Efforts are on-going to complete pending cooling seawater thermal discharge under the Clean Water Act “National Pollutant Discharge Elimination System” operating permits program, for the four Thermoelectric Power Plants. Specifically for South Coast Power Plant, extensive negotiations led to a cooperative effort as to which alternative should be developed under a Detail Evaluation Engineer Review (DEER). Meetings have been conducted at different stages of the work plan to address and keep informed the Guayanilla Community Group. Conversations are still in progress to determine the specific route through the two corridors identified for an Offshore Submerged Discharge. Draft National Pollutant Discharge Elimination System (NPDES) permit for South Coast Power Plant was issued by EPA in September 30, 2009. As expected, it included a work plan for the alternative development and its permitting process. Conversations with the Army Corps of Engineer as part of the permitting process required are in its initial stages.

The fieldwork of the Aguirre 316 Demonstration Study finished in May 2004 and the Final Report was submitted by May 2005.

The Authority submitted to EPA the reports and waiver requests, pursuant to the Clean Water Act-Section 316(a) Thermal Waiver, for the San Juan and Palo Seco power plants on July 11, 1997 and November 18, 1997, respectively. EPA issued a new NPDES Permit for the San Juan Power Plant in April 2007, including the approval of the 316(a) Waiver

**Commitments to Purchase Power**

In October 1994, the Authority signed a contract with AES Puerto Rico, L.P. (“AES”) to purchase power of approximately 454 megawatts generated from a coal fluidized bed combustion facility. The term of the agreement is for twenty-five (25) years. This project commenced operations in November 2002.

In March 1995, the Authority also signed a contract with EcoEléctrica, L.P. (“EcoEléctrica”) to purchase power of approximately 507 megawatts from a gas-fired combined cycle power plant. The term of the agreement is for twenty-two (22) years. This project has been in operation since 2000.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

**Commitments to Purchase Power (continued)**

Under both agreements, the cost of the purchased power will be based on the quantity of energy delivered and dependable capacity available, as more fully explained in the contracts. The Authority also has the option to purchase the generating facilities if certain conditions, as defined in the contracts, are met. However, in no event will the exercise price of each of the purchase options be below fair value. The Authority is not responsible for and does not guarantee the debt or operations of AES or EcoEléctrica. Both contracts obligate the Authority to purchase power only if generated by the plants.

**Risk Management**

The Authority is exposed to various risks of losses related to torts; thefts of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority obtains insurance policies covering all-risk property (excluding transmission and distribution lines), boiler and machinery and public liability. The all-risk property and boiler and machinery policies have a combined coverage of \$750 million per occurrence. The policies' self-retention in case of earthquake and windstorm losses is \$25 million, \$2 million for all other covered risks and \$10 million for Boiler and Machinery. The public general liability policy covers property damage and bodily injury to third parties with a \$75 million aggregate limit in excess of the self-retention limit of \$1 million per occurrence.

The Authority considers its Self-insurance Fund sufficient to provide for its self-insurance risk (see Note 5). Claims expenditures and liabilities are recorded when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated.

The Authority has a cost plus health insurance program covering substantially all employees. The Authority contracted an administrator for the processing, approval and payment of claims plus an administrative fee. The accrual for employees' health plan includes the liability for claims processed and an estimate for claims incurred but not reported.

The State Insurance Fund Corporation ("SIF") provides workers' compensation to the Authority. In addition, the Authority is self-insured to pay the difference between the SIF payment and (i) 100% of the employee salary during the first 104 weeks and (ii) 80% of the employee salary for 52 additional weeks.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

**Risk Management (continued)**

Changes in the balances of the health insurance program (self-insurance risk) incurred but not recorded (IBNR) during fiscal years 2009 and 2008 were as follows:

|             | <b>Liability<br/>Beginning<br/>Balance</b> | <b>Expenses</b>   | <b>Payments</b>   | <b>Liability<br/>Ending<br/>Balance</b> |
|-------------|--|-------------------|-------------------|---|
|             | <i>(In thousands)</i>                      |                   |                   |   |
| <b>2008</b> | \$ 11,273                                  | \$ 132,358        | \$ 136,477        | \$ 7,154                                |
| <b>2009</b> | <b>\$ 7,154</b>                            | <b>\$ 136,348</b> | <b>\$ 137,950</b> | <b>\$ 5,552</b>                         |

**Contingencies**

The Authority is a defendant or codefendant in several lawsuits incidental to its business, some involving substantial amounts. In those instances that management and legal counsel believe that the outcome of the litigation will be unfavorable to the Authority, a provision has been made to cover the estimated liability. Management, based on discussions with legal counsel, believes that the additional liability, if any, resulting from the ultimate resolution of these matters will not have a material effect on the Authority's financial position or results of operations.

On May 18, 2000, Abengoa, Puerto Rico, S.E. (“Abengoa”), the Authority's contractor for the repowering of San Juan steam plant units 5 and 6, unilaterally declared a termination of the contract with the Authority and filed a complaint for breach of contract. The Authority has moved for time to answer the complaint and has filed a counter claim for the cost of the project and for all damages caused to the Authority by the alleged illegal contract termination. The Authority believes that the actions by the contractor will not materially affect the ability of the Authority to provide service nor there will be a material difference in the quality of service provided by the Authority.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

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

**Contingencies (continued)**

In June 2004, the Office of the Comptroller of the Commonwealth of Puerto Rico (the “Comptroller”) issued a report stating that the Authority overcharged its clients by approximately \$49.8 million, and should reimburse this amount to such clients. After this report was made public, two lawsuits were filed by clients of the Authority against the Authority demanding the reimbursement of such alleged overcharges. The Authority’s position is that the Comptroller incorrectly based his conclusion on data that is not relevant to the calculation of the Authority’s rates, and that the Authority’s rates were properly established in the year 2000 in accordance with applicable laws and regulations. In particular, the Authority notes that its rates properly take into consideration the cost of the fuel used by the Authority’s generating facilities and the cost of the electricity purchased from the two co-generating facilities that sell power to the Authority.

**Construction and Other Commitments**

As of June 30, 2009, the Authority has commitments of approximately \$127.4 million on active construction, maintenance and engineering services contracts.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures*, which more closely aligns current pension disclosure requirements for governments with those that governments are beginning to implement for retiree health insurance and other post-employment benefits.

**18. Significant New Accounting Pronouncement**

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, to provide guidance regarding how to identify, account for, and report intangible assets.

The new standard characterizes an intangible asset as an asset that lacks physical substance, is nonfinancial in nature, and has an initial useful life extending beyond a single reporting period. Examples of intangible assets include easements, computer software, water rights, timber rights, patents, and trademarks.

Puerto Rico Electric Power Authority  
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Notes to Audited Financial Statements (continued)

**18. Significant New Accounting Pronouncement (continued)**

Statement No. 51 requires that intangible assets be classified as capital assets (except for those explicitly excluded from the scope of the new standard, such as capital leases). Relevant authoritative guidance for capital assets should be applied to these intangible assets.

Statement No. 51 provides additional guidance that specifically addresses the unique nature of intangible assets, including:

- Requiring that an intangible asset be recognized in the statement of net assets only if it is considered identifiable
- Establishing a specified-conditions approach to recognizing intangible assets that are internally generated (for example, patents and copyrights)
- Providing guidance on recognizing internally generated computer software
- Establishing specific guidance for the amortization of intangible assets.

The requirements Statement 51 are effective for financial statements for periods beginning after June 15, 2009. The GASB made significant changes to the transition provisions, based on constituent response to the proposed version of the standards, to make it easier for governments to implement.

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 is intended to improve how state and local governments report information about derivative instruments—financial arrangements used by governments to manage specific risks or make investments—in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

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

Notes to Audited Financial Statements (continued)

**19. Subsequent Events**

On October 23, 2009, a fire at Caribbean Petroleum Refining LC (“CPR”) facilities, which are rented by the Authority to allow a supplier to store fuel, had an immediate effect on the price of fuel as the Authority contracted supplier declared force majeure on its contract due to the loss of the blending operations that took place at the facility. Price increase has been limited to approximately \$3.00 per barrel equivalent to around 4 percent at current fuel oil prices. Availability of fuel has not been an issue. The Authority’s Governing Board authorized the purchase of fuel on an emergency basis to secure Palo Seco and San Juan steam plants operations.

On January 10, 2008, the Authority and Skanska Energy Services, LLC (“Skanska”) entered into an Engineer Procure Construct Finance Contract for the construction of the Gasoducto del Sur Project (the “Project”) for an original Contract Price of \$74,324,259. On December 2, 2008, the Superior Court of Ponce issued an injunction stopping all construction. On July 23, 2009, PREPA’s Governing Board authorized the termination and settlement of the Contract. The Authority obtained title to all equipment and material procured and 100% of engineering documents and all pending disputes were settled for a lump-sum payment of \$59,000,000 due to the Contractor. The Termination and Settlement Agreement was executed on August 7, 2009. Pursuant to an Asset Purchase Agreement dated August 17, 2009, PREPA sold the assets of the Gasoducto del Sur Project to The Puerto Rico Industrial, Tourist, Educational, Medical and Environmental Control Facilities Financing Authority (AFICA by its Spanish acronym) for approximately \$36 million. In addition, PREPA entered into a Subordinated Loan Agreement with the Government Development Bank (GDB) for \$35,000,000 evidenced by a 24-month subordinated note until such time that Puerto Rico Aqueduct and Sewer Authority (PRASA) shall purchase from AFICA the Project.

On December 16, 2009, the Authority and a financial institution entered into an agreement for a line of credit of \$150 million to finance a portion of the cost of various projects under its capital improvement program. This line of credit will be paid with proceeds from a bond issuance expected to occur during the third quarter of the fiscal year ending June 30, 2010.

The Authority is expected to issue Power Revenue Bonds to finance a portion of the cost of various projects under its capital improvement program and to pay certain bond anticipation notes. Upon market conditions the Authority is expected to issue Power Revenue Refunding Bonds. The refunding will enable the Authority to realize savings on its debt service requirements on bonds outstanding under the 1974 Agreement. This bond issuance is expected to occur during the third quarter of the fiscal year ending June 30, 2010.

## Required Supplementary Information

## Schedule I

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

#### Supplementary Schedule of Funding Progress

June 30, 2009

*(In millions)*

| Actuarial Valuation Date          | Actuarial<br>Value of<br>Assets<br>(a) Note 1 | Actuarial<br>Accrued<br>Liability<br>(AAL)<br>(b) | Unfunded<br>AAL<br>(UAAL)<br>(b) - (a) | Funded<br>Ratio<br>(a)/(b) | Covered<br>Payroll<br>(c) | UAAL<br>Percentage<br>Of Covered<br>Payroll<br>[(b) -<br>(a)]/(c) |
|-----------------------------------|---|---|--|----------------------------|---------------------------|---|
| <u>Pension Plan</u>               |   |   |  |                            |                           |   |
| 6/30/97                           | \$1,084                                       | \$1,333   | \$ 249                                 | 51%                        | \$271                     | 92%   |
| 6/30/98*                          | 1,268   | 1,495   | 227                                    | 85%                        | 274                       | 83%   |
| 6/30/99**                         | 1,443   | 1,538   | 95                                     | 94%                        | 277                       | 34%   |
| 6/30/00                           | 1,550   | 1,799   | 250                                    | 86%                        | 278                       | 90%   |
| 6/30/01                           | 1,547   | 1,964   | 417                                    | 79%                        | 290                       | 144%  |
| 6/30/02                           | 1,441   | 2,012   | 572                                    | 72%                        | 298                       | 192%  |
| 6/30/03                           | 1,337   | 2,137   | 799                                    | 63%                        | 306                       | 262%  |
| 6/30/04                           | 1,294   | 2,139   | 846                                    | 60%                        | 335                       | 252%  |
| 6/30/05                           | 1,338   | 2,203   | 866                                    | 61%                        | 349                       | 248%  |
| 6/30/06                           | 1,403   | 2,280   | 877                                    | 62%                        | 349                       | 251%  |
| 6/30/07                           | 1,488   | 2,313   | 826                                    | 64%                        | 349                       | 237%  |
| 6/30/08                           | 1,571   | 2,337   | 766                                    | 67%                        | 363                       | 211%  |
| <u>Postemployment Health Plan</u> |   |   |  |                            |                           |   |
| 6/30/07                           | -   | 3,375   | 3,375                                  | 0%                         | 349                       | 967%  |
| 6/30/08                           | -   | 531   | 531                                    | 0%                         | 349                       | 152%  |

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

\* *Estimated valuation, projected from actual 6/30/98 valuation.*

\*\* *Estimated valuation, projected from actual 6/30/99 valuation. Does not reflect benefit improvements effective January 1, 2000.*

## Supplemental Schedules

Puerto Rico Electric Power Authority  
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Note to Schedules II-VII - Information Required by the 1974 Agreement

As of June 30, 2009 and 2008, and for the Years then Ended

Schedules II - VII 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.

Puerto Rico Electric Power Authority  
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Supplemental Schedule of Sources and Disposition of Net Revenues  
under the Provisions of the 1974 Agreement

Statements of Income (GAAP) and Reconciliation of Net Income

For the Years Ended June 30, 2009 and 2008  
(In thousands)

|  | 2009                       |                                  |                                    | 2008                       |                                  |                                    |
|--|----------------------------|----------------------------------|------------------------------------|----------------------------|----------------------------------|------------------------------------|
|  | 1974<br>Trust<br>Agreement | Statement<br>of Income<br>(GAAP) | Reconciliation<br>of Net<br>Income | 1974<br>Trust<br>Agreement | Statement<br>of Income<br>(GAAP) | Reconciliation<br>of Net<br>Income |
| Reconciliation of components of net income:  |                            |                                  |                                    |                            |                                  |                                    |
| Revenues:  |                            |                                  |                                    |                            |                                  |                                    |
| Operating revenues   | \$ 3,986,180               | \$ 4,002,713                     |                                    | \$ 4,350,515               | \$ 4,362,209                     |                                    |
| Revenues from Commonwealth for rural electrification                                       | 19                         | 19                               |                                    | 26                         | 26                               |                                    |
| Other operating revenues   | 14,641                     | 14,641                           |                                    | 22,210                     | 22,210                           |                                    |
| Other  | 6,428                      | 6,590                            |                                    | (3,254)                    | (3,283)                          |                                    |
| 1974 agreement construction fund investment income<br>and gain on sale of other properties | —                          | 19,640                           |                                    | —                          | 45,903                           |                                    |
| Total revenues   | <u>4,007,268</u>           | <u>4,043,603</u>                 | <u>36,335</u>                      | <u>4,369,497</u>           | <u>4,427,065</u>                 | <u>57,568</u>                      |
| Current expenses:  |                            |                                  |                                    |                            |                                  |                                    |
| As shown   | 3,377,772                  | 3,389,307                        |                                    | 3,688,070                  | 3,696,334                        |                                    |
| Other interest   | —                          | 2,819                            |                                    | —                          | 3,963                            |                                    |
| Total as defined   | <u>3,377,772</u>           | <u>3,392,126</u>                 | <u>(14,354)</u>                    | <u>3,688,070</u>           | <u>3,700,297</u>                 | <u>(12,227)</u>                    |
| Net revenues, as defined   | <u>\$ 629,496</u>          |                                  |                                    | <u>\$ 681,427</u>          |                                  |                                    |
| Depreciation   | \$ —                       | 306,118                          | (306,118)                          | \$ —                       | 295,317                          | (295,317)                          |
| Other post-employment benefit (OPEB)   | —                          | (55,316)                         | 55,316                             | —                          | 189,492                          | (189,492)                          |
| Disposition of revenues: (not classified in order of payment)                              |                            |                                  |                                    |                            |                                  |                                    |
| Interest on debt   | 261,486                    | 299,173                          |                                    | 255,593                    | 271,016                          |                                    |
| Interest on general obligation notes   | 28,434                     | 28,798                           |                                    | 44,290                     | 44,291                           |                                    |
| Amortization of debt discount, financing expenses  | —                          | (7,197)                          |                                    | —                          | (7,478)                          |                                    |
| Amortization of bond defeasance  | —                          | 21,102                           |                                    | —                          | 21,602                           |                                    |
| Allowance for funds used during construction   | —                          | (18,530)                         |                                    | —                          | (21,125)                         |                                    |
| Net interest on long-term debt   | <u>289,920</u>             | <u>323,346</u>                   | <u>(33,426)</u>                    | <u>299,883</u>             | <u>308,306</u>                   | <u>(8,423)</u>                     |
| Power revenue bonds:   |                            |                                  |                                    |                            |                                  |                                    |
| Principal  | 173,040                    | —                                | 173,040                            | 164,492                    | —                                | 164,492                            |
| Reserve Account  | (29,523)                   | —                                | (29,523)                           | —                          | —                                | —                                  |
| Internal Funds   | 4,695                      | —                                | 4,695                              | 11,400                     | —                                | 11,400                             |
| Appropriation Self Insurance Fund  | 10,000                     | —                                | 10,000                             | (20,438)                   | —                                | (20,438)                           |
| Contribution in lieu of taxes  | 181,364                    | 224,792                          | (43,428)                           | 226,090                    | 218,379                          | 7,711                              |
| Total expenses (GAAP)  |                            | <u>4,191,066</u>                 |                                    |                            | <u>4,711,791</u>                 |                                    |
| Net revenues, as defined   | <u>\$ 629,496</u>          |                                  |                                    | <u>\$ 681,427</u>          |                                  |                                    |
| Net income   |                            | <u>\$ (147,463)</u>              | <u>\$ (147,463)</u>                |                            | <u>\$ (284,726)</u>              | <u>\$ (284,726)</u>                |

**Schedule III**

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

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

For the Years Ended June 30, 2009 and 2008  
(In thousands)

|  | 2009         | 2008         |
|--|--------------|--------------|
| Sources of net revenues:                                 |              |              |
| Revenues:  |              |              |
| Electric revenues  | \$ 3,986,180 | \$ 4,350,515 |
| Revenues from the Commonwealth for rural electrification | 19           | 26           |
| Other operating revenues                                 | 14,641       | 22,210       |
| Other (principally interest)                             | 6,428        | (3,254)      |
|  | 4,007,268    | 4,369,497    |
| Current expenses:  |              |              |
| Operations:  |              |              |
| Fuel   | 1,919,789    | 2,303,036    |
| Purchased power  | 671,849      | 661,097      |
| Fuel extra expense claimed                               | -            | (96,273)     |
| Other production   | 62,271       | 57,507       |
| Transmission and distribution                            | 162,334      | 171,585      |
| Customer accounting and collection                       | 111,126      | 118,196      |
| Administrative and general                               | 222,477      | 220,553      |
| Maintenance  | 225,107      | 248,406      |
| Other Interest   | 2,819        | 3,963        |
|  | 3,377,772    | 3,688,070    |
| Net revenues, as defined                                 | \$ 629,496   | \$ 681,427   |
| Disposition of net revenues:                             |              |              |
| Revenue fund:  |              |              |
| Power revenue bonds - sinking fund requirements:         |              |              |
| Interest   | \$ 261,486   | \$ 255,593   |
| Principal  | 173,040      | 164,492      |
| Reserve Account  | (29,523)     | -            |
| Self Insurance Fund                                      | 10,000       | (20,438)     |
| Balance available for capital improvements               | 4,695        | 11,400       |
|  | 419,698      | 411,047      |
| General obligation notes:                                |              |              |
| Interest   | 28,434       | 44,290       |
| Contribution in lieu of taxes and other                  | 181,364      | 226,090      |
| Net revenues, as defined                                 | \$ 629,496   | \$ 681,427   |

*See accompanying notes.*

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

Supplemental Schedule of Funds under the Provisions of the  
1974 Agreement

Years Ended June 30, 2009 and 2008  
(In thousands)

|  | 2009              |   |  |                       | 2008                |   |  |                       |
|--|-------------------|---|--|-----------------------|---------------------|---|--|-----------------------|
|  | Total             | Held by<br>Authority<br>Other<br>Assets | Restricted<br>Deposits with Trustee<br>Other<br>Assets | Non-Current<br>Assets | Total               | Held by<br>Authority<br>Other<br>Assets | Restricted<br>Deposits with Trustee<br>Other<br>Assets | Non-Current<br>Assets |
| <b>By Account</b>  |                   |   |  |                       |                     |   |  |                       |
| 1974 Agreement (restricted)                                  |                   |   |  |                       |                     |   |  |                       |
| Sinking Fund - principal and interest                        | \$ 304,480        | \$ -                                    | \$ 304,480   | \$ -                  | \$ 281,624          | \$ -                                    | \$ 281,624   | \$ -                  |
| Reserve account  | 267,001           | -                                       | -  | 267,001               | 287,832             | -                                       | -  | 287,832               |
| Self insurance fund  | 62,624            | -                                       | -  | 62,624                | 51,086              | -                                       | -  | 51,086                |
| Reserve maintenance fund                                     | 5,573             | 5,573                                   | -  | -                     | 569                 | 569                                     | -  | -                     |
| Other restricted fund  | 2,410             | 2,410                                   | -  | -                     | -                   | -                                       | -  | -                     |
| Construction Fund:   |                   |   |  |                       |                     |   |  |                       |
| Rural Utilities Services (RUS)                               | 1,911             | 1,911                                   | -  | -                     | 1,896               | 1,896                                   | -  | -                     |
| Other  | 13,894            | 13,894                                  | -  | -                     | 565,369             | 565,369                                 | -  | -                     |
| General purpose (unrestricted):                              |                   |   |  |                       |                     |   |  |                       |
| General  | 64,725            | 64,725                                  | -  | -                     | 30,406              | 30,406                                  | -  | -                     |
| Working funds  | 1,048             | 1,048                                   | -  | -                     | 1,777               | 1,777                                   | -  | -                     |
| Total  | <u>\$ 723,666</u> | <u>\$ 89,561</u>                        | <u>\$ 304,480</u>                                      | <u>\$ 329,625</u>     | <u>\$ 1,220,559</u> | <u>\$ 600,017</u>                       | <u>\$ 281,624</u>                                      | <u>\$ 338,918</u>     |
| <b>By Type of Assets Held</b>                                |                   |   |  |                       |                     |   |  |                       |
| Working funds  | \$ 1,048          | \$ 1,048                                | \$ -   | \$ -                  | \$ 1,777            | \$ 1,777                                | \$ -   | \$ -                  |
| Cash in bank and time deposits (by depository institutions): |                   |   |  |                       |                     |   |  |                       |
| Government Development Bank for Puerto Rico                  | 1,047             | 1,047                                   | -  | -                     | 517,304             | 517,304                                 | -  | -                     |
| Banco Popular de Puerto Rico                                 | 40,334            | 40,334                                  | -  | -                     | 13,144              | 13,144                                  | -  | -                     |
| Citibank, N. A.  | 34,305            | 34,305                                  | -  | -                     | 16,157              | 16,157                                  | -  | -                     |
| US Bank  | 304,480           | -                                       | 304,480  | -                     | 281,624             | -                                       | 281,624  | -                     |
| Banco Bilbao Vizcaya   | 12                | 12                                      | -  | -                     | 1,848               | 1,848                                   | -  | -                     |
| Banco Bilbao Vizcaya, Mayagüez, Puerto Rico                  | 46                | 46                                      | -  | -                     | (163)               | (163)                                   | -  | -                     |
| First Bank, San Juan, Puerto Rico                            | 350               | 350                                     | -  | -                     | 551                 | 551                                     | -  | -                     |
| Banco Santander, Santurce, Puerto Rico                       | 3,865             | 3,865                                   | -  | -                     | 9,108               | 9,108                                   | -  | -                     |
| RG Premier Bank  | 118               | 118                                     | -  | -                     | (20)                | (20)                                    | -  | -                     |
| Western Bank, Mayagüez, Puerto Rico                          | 752               | 752                                     | -  | -                     | 725                 | 725                                     | -  | -                     |
| JP Morgan  | 200               | 200                                     | -  | -                     | -                   | -                                       | -  | -                     |
| Other institutions   | 990               | 990                                     | -  | -                     | 972                 | 972                                     | -  | -                     |
|  | <u>387,547</u>    | <u>83,067</u>                           | <u>304,480</u>   | <u>-</u>              | <u>843,027</u>      | <u>561,403</u>                          | <u>281,624</u>   | <u>-</u>              |
| Investment securities  | <u>336,119</u>    | <u>6,494</u>                            | <u>-</u>   | <u>329,625</u>        | <u>377,532</u>      | <u>38,614</u>                           | <u>-</u>   | <u>338,918</u>        |
| Total  | <u>\$ 723,666</u> | <u>\$ 89,561</u>                        | <u>\$ 304,480</u>                                      | <u>\$ 329,625</u>     | <u>\$ 1,220,559</u> | <u>\$ 600,017</u>                       | <u>\$ 281,624</u>                                      | <u>\$ 338,918</u>     |

See accompanying notes.

## Schedule V

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

Supplemental Schedule of Changes in Cash and Investments by Funds

Year Ended June 30, 2009  
(In thousands)

|   | General Purposes Funds |                  |              |                 |                         |
|---|------------------------|------------------|--------------|-----------------|-------------------------|
|   | Total                  | General Fund     | Revenue Fund | Working Fund    | Interest 1974 Agreement |
| <b>2008 - 2009 Activity</b>   |                        |                  |              |                 |                         |
| <b>Balances at June 30, 2008</b>  | \$ 1,220,559           | \$ 110,876       | \$ 10        | \$ 1,777        | \$ 117,510              |
| Operations:   |                        |                  |              |                 |                         |
| Net revenues  | -                      | (629,496)        | 181,364      | -               | 261,486                 |
| Funds provided from internal operations   | 450,714                | 450,714          | -            | -               | -                       |
| 1974 Agreement investment income Acct 4191  | -                      | (4,076)          | -            | -               | -                       |
| Investment income and other   | 26,926                 | 7,903            | -            | -               | 1,523                   |
| Unrealized gain (or loss) on market value of investment   | (1,401)                | -                | -            | -               | -                       |
| Offset of current year's contribution in lieu of taxes against certain government accounts receivable                                   | -                      | 139,294          | (139,294)    | -               | -                       |
| Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to general obligations | -                      | 42,070           | (42,070)     | -               | -                       |
| Funds used for construction   | (478,719)              | -                | -            | -               | -                       |
| Reclassified constructions costs for deferred debits  | (40,695)               | (40,695)         | -            | -               | -                       |
| Financing:  |                        |                  |              |                 |                         |
| Proceeds from new bond issues-net of original discounts   | -                      | -                | -            | -               | -                       |
| Proceeds from contributed capital   | 12,661                 | -                | -            | -               | -                       |
| Sinking Funds and account transfers   | -                      | (5,000)          | -            | -               | 37,171                  |
| Notes issued for construction   | 98,000                 | -                | -            | -               | -                       |
| Notes issued for municipalities settlement agreement  | -                      | -                | -            | -               | -                       |
| Notes issued to working capital   | 195,000                | 195,000          | -            | -               | -                       |
| Note issued to finance the adquisition on fuel oil  | 50,000                 | 50,000           | -            | -               | -                       |
| Notes issued to finance the recovery of Palo Seco Steam Plant that are payable from proceeds from insurance companies                   | -                      | -                | -            | -               | -                       |
| Payment of notes  | (447,471)              | (247,471)        | -            | -               | -                       |
| Payment of interest   | (313,397)              | (11,064)         | -            | -               | (270,797)               |
| Payment to counterparties - Interest Rate Swap  | (14,556)               | (14,556)         | -            | -               | -                       |
| Payment of current maturities of long-term debt   | (164,511)              | -                | -            | -               | -                       |
| Payment to municipalities settlement agreement  | -                      | -                | -            | -               | -                       |
| Changes in assets and liabilities:  |                        |                  |              |                 |                         |
| Working funds   | -                      | 729              | -            | (729)           | -                       |
| Accounts receivable (includes non-current)  | 128,259                | 128,259          | -            | -               | -                       |
| Fuel oil  | 12,828                 | 12,828           | -            | -               | -                       |
| Materials and supplies  | (7,517)                | (7,517)          | -            | -               | -                       |
| Prepayments and other   | 300                    | 300              | -            | -               | -                       |
| Deferred debits   | 50,659                 | 50,659           | -            | -               | -                       |
| Accounts payable and accrued liabilities (includes non-current)   | (59,490)               | (75,773)         | -            | -               | -                       |
| Customer deposits   | 5,517                  | 5,517            | -            | -               | -                       |
| Interfund transfers, etc.   | -                      | 7,697            | 6            | -               | (9,308)                 |
| <b>Total before interfund accounts</b>  | <b>723,666</b>         | <b>166,198</b>   | <b>16</b>    | <b>1,048</b>    | <b>137,585</b>          |
| Add (deduct) Interfund accounts   | -                      | (101,489)        | -            | -               | -                       |
| <b>Balances at June 30, 2009</b>  | <b>\$ 723,666</b>      | <b>\$ 64,709</b> | <b>\$ 16</b> | <b>\$ 1,048</b> | <b>\$ 137,585</b>       |

| Sinking Fund                   |                              |                           | Other Funds                       |                                |                                    |                             |
|--------------------------------|------------------------------|---------------------------|-----------------------------------|--------------------------------|------------------------------------|-----------------------------|
| Principal<br>1974<br>Agreement | Reserve<br>1974<br>Agreement | Self<br>Insurance<br>Fund | Construction<br>1974<br>Agreement | Reserve<br>Maintenance<br>Fund | Subordinated<br>Obligation<br>Fund | Other<br>Restricted<br>Fund |
| \$ 164,114                     | \$ 287,832                   | \$ 51,086                 | \$ 486,785                        | \$ 569                         | \$ -                               | \$ -                        |
| 173,040                        | (29,523)                     | 10,000                    | 4,695                             | -                              | 28,434                             | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | 4,076                             | -                              | -                                  | -                           |
| 1,697                          | 9,816                        | 1,818                     | 4,165                             | 4                              | -                                  | -                           |
| -                              | (1,120)                      | (281)                     | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | (478,719)                         | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | 12,661                            | -                              | -                                  | -                           |
| -                              | -                            | -                         | (37,171)                          | 5,000                          | -                                  | -                           |
| -                              | -                            | -                         | 98,000                            | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | (200,000)                         | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | (31,536)                           | -                           |
| (164,511)                      | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| -                              | -                            | -                         | 16,283                            | -                              | -                                  | -                           |
| -                              | -                            | -                         | -                                 | -                              | -                                  | -                           |
| (7,445)                        | (4)                          | 1                         | 3,541                             | -                              | 3,102                              | 2,410                       |
| 166,895                        | 267,001                      | 62,624                    | (85,684)                          | 5,573                          | -                                  | 2,410                       |
| -                              | -                            | -                         | 101,489                           | -                              | -                                  | -                           |
| <b>\$ 166,895</b>              | <b>\$ 267,001</b>            | <b>\$ 62,624</b>          | <b>\$ 15,805</b>                  | <b>\$ 5,573</b>                | <b>\$ -</b>                        | <b>\$ 2,410</b>             |

## Schedule V

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

Supplemental Schedule of Changes in Cash and Investments by Funds

Year Ended June 30, 2008  
(In thousands)

|   | General Purposes Funds |                  |              |                 |                         |
|---|------------------------|------------------|--------------|-----------------|-------------------------|
|   | Total                  | General Fund     | Revenue Fund | Working Fund    | Interest 1974 Agreement |
| <b>2007 - 2008 Activity</b>   |                        |                  |              |                 |                         |
| <b>Balances at June 30, 2007, before interfund account</b>  | \$ 1,049,128           | \$ 104,509       | \$ 16        | \$ 1,576        | \$ 90,704               |
| Operations:   |                        |                  |              |                 |                         |
| Net revenues  | -                      | (681,427)        | 226,090      | -               | 255,593                 |
| Funds provided from internal operations   | 318,054                | 318,054          | -            | -               | -                       |
| 1974 Agreement investment income Acct 4191  | -                      | (6,922)          | -            | -               | -                       |
| Investment income and other   | 22,733                 | -                | -            | -               | 2,009                   |
| Unrealized gain (or loss) on market value of investment   | 2,430                  | -                | -            | -               | -                       |
| Offset of current year's contribution in lieu of taxes against certain government accounts receivable                                   | -                      | 188,313          | (188,313)    | -               | -                       |
| Offset of current year's 5% contribution in lieu of taxes against Commonwealth of Puerto Rico debt and transfers to general obligations | -                      | 37,777           | (37,777)     | -               | -                       |
| Funds used for construction   | (639,263)              | -                | -            | -               | -                       |
| Financing:  |                        |                  |              |                 |                         |
| Proceeds from new bond issues-net of original discounts   | 687,125                | -                | -            | -               | -                       |
| Proceeds from contributed capital   | 17,379                 | -                | -            | -               | -                       |
| Sinking Funds and account transfers   | -                      | 71,782           | -            | -               | 21,319                  |
| Notes issued for construction   | 200,000                | -                | -            | -               | -                       |
| Notes issued for municipalities settlement agreement  | 15,229                 | -                | -            | -               | -                       |
| Notes issued to working capital   | 16,000                 | 16,000           | -            | -               | -                       |
| Note issued to finance the acquisition on fuel oil  | 100,000                | 100,000          | -            | -               | -                       |
| Notes issued to finance the recovery of Palo Seco Steam Plant that are payable from proceeds from insurance companies                   | 200,000                | 200,000          | -            | -               | -                       |
| Payment of notes  | (112,277)              | (112,277)        | -            | -               | -                       |
| Payment of interest   | (293,019)              | -                | -            | -               | (241,624)               |
| Payment to counterparties - Interest Rate Swap  | (1,141)                | (1,141)          | -            | -               | -                       |
| Payment of current maturities of long-term debt   | (197,583)              | -                | -            | -               | -                       |
| Payment to municipalities settlement agreement  | (15,229)               | -                | -            | -               | -                       |
| Changes in assets and liabilities:  |                        |                  |              |                 |                         |
| Working funds   | -                      | (201)            | -            | 201             | -                       |
| Accounts receivable (includes non-current)  | (333,947)              | (333,947)        | -            | -               | -                       |
| Fuel oil  | (55,442)               | (55,442)         | -            | -               | -                       |
| Materials and supplies  | (30,350)               | (30,350)         | -            | -               | -                       |
| Prepayments and other   | 3,537                  | 3,537            | -            | -               | -                       |
| Deferred debits   | (21,242)               | (21,242)         | -            | -               | -                       |
| Accounts payable and accrued liabilities (includes non-current)   | 283,066                | 283,066          | -            | -               | -                       |
| Customer deposits   | 5,371                  | 5,371            | -            | -               | -                       |
| Interfund transfers, etc.   | -                      | 25,416           | (6)          | -               | (10,491)                |
| Total before interfund accounts   | 1,220,559              | 110,876          | 10           | 1,777           | 117,510                 |
| Add (deduct) Interfund accounts   | -                      | (80,480)         | -            | -               | -                       |
| <b>Balances at June 30, 2008</b>  | <b>\$ 1,220,559</b>    | <b>\$ 30,396</b> | <b>\$ 10</b> | <b>\$ 1,777</b> | <b>\$ 117,510</b>       |

| Sinking Fund                   |                              |                           | Other Funds                       |                                |                                    |
|--------------------------------|------------------------------|---------------------------|-----------------------------------|--------------------------------|------------------------------------|
| Principal<br>1974<br>Agreement | Reserve<br>1974<br>Agreement | Self<br>Insurance<br>Fund | Construction<br>1974<br>Agreement | Reserve<br>Maintenance<br>Fund | Subordinated<br>Obligation<br>Fund |
| \$ 202,313                     | \$ 273,108                   | \$ 68,922                 | \$ 259,740                        | \$ 48,240                      | \$ -                               |
| 164,492                        | -                            | (20,438)                  | 11,400                            | -                              | 44,290                             |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | 6,922                             | -                              | -                                  |
| 3,496                          | 11,943                       | 2,352                     | 1,507                             | 1,426                          | -                                  |
| -                              | 2,677                        | 254                       | -                                 | (501)                          | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | (639,263)                         | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | 687,125                           | -                              | -                                  |
| -                              | -                            | -                         | 17,379                            | -                              | -                                  |
| -                              | -                            | -                         | (44,508)                          | (48,593)                       | -                                  |
| -                              | -                            | -                         | 200,000                           | -                              | -                                  |
| -                              | -                            | -                         | 15,229                            | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | (51,395)                           |
| (197,583)                      | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | (15,229)                          | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| -                              | -                            | -                         | -                                 | -                              | -                                  |
| (8,604)                        | 104                          | (4)                       | (13,517)                          | (3)                            | 7,105                              |
| 164,114                        | 287,832                      | 51,086                    | 486,785                           | 569                            | -                                  |
| -                              | -                            | -                         | 80,480                            | -                              | -                                  |
| <b>\$ 164,114</b>              | <b>\$ 287,832</b>            | <b>\$ 51,086</b>          | <b>\$ 567,265</b>                 | <b>\$ 569</b>                  | <b>\$ -</b>                        |

**Schedule VI**

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

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

Years Ended June 30, 2009 and 2008  
(In thousands)

|  | 2009         | 2008         |
|--|--------------|--------------|
| <b>Long-term debt excluding current portion</b>                          |              |              |
| Balance at the beginning of year   | \$ 6,515,536 | \$ 6,006,144 |
| Transfers to current liabilities:  |              |              |
| Power revenue bonds  | (637,709)    | (434,187)    |
| Payment of general obligation notes:                                     |              |              |
| Note payable   | (200,000)    | —            |
| Remainder  | 5,677,827    | 5,571,957    |
| <br>New issues:  |              |              |
| Power revenue bonds  | —            | 697,345      |
| Power revenue refunding bonds  | —            | —            |
| Debt discount on new bond issues - net                                   | —            | 4,905        |
| Defeasance of bonds  | —            | —            |
| Debt discount and excess reacquisition costs on<br>cancelled bonds - net | —            | —            |
| Notes payable  | 98,000       | 241,329      |
| Balance at the end of year   | \$ 5,775,827 | \$ 6,515,536 |
| <br><b>Current portion of long-term debt</b>                             |              |              |
| Balance at beginning of year   | \$ 598,296   | \$ 363,358   |
| Transfer from long-term debt   | 637,709      | 434,187      |
| Payments to bondholders:   |              |              |
| Power revenue- July 1  | (164,111)    | (197,202)    |
| Power revenue- January 1   | (400)        | (381)        |
| General obligation notes   | (14,093)     | (12,277)     |
| Total payments   | (178,604)    | (209,860)    |
| <br>Amortization of debt discount and excess<br>reacquisition costs      | 9,909        | 10,611       |
| Balance at end of year   | \$ 1,067,310 | \$ 598,296   |

*See accompanying notes.*

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