KPMG

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

Basic Financial Statements and
Required Supplementary Information

June 30, 2014

(With Independent Auditors' Report Thereon)

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

Table of Contents

KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Board of Directors
Puerto Rico Sales Tax Financing Corporation:

We have audited the accompanying financial statements of the governmental activities and each major fund of the Puerto Rico Sales Tax Financing Corporation (the Corporation), a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly in all material respects, the financial position of the governmental activities and each major fund of the Puerto Rico Sales Tax Financing Corporation as of June 30, 2014, and the respective changes in financial position for the year then ended in accordance with U.S. generally accepted accounting principles.

Other matters

Adoption of New Accounting Principle

As discussed in note 2 to the financial statements, in fiscal year 2014, the Corporation adopted new accounting guidance in Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Required supplementary information

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 3 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considered it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the management's discussion and analysis in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

San Juan, Puerto Rico
June 11, 2015

Stamp No. E161585 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

As management of the Puerto Rico Sales Tax Financing Corporation (the Corporation), we offer readers of the Corporation’s financial statements this narrative overview and analysis of the financial performance during the fiscal year ended June 30, 2014. Please read it in conjunction with the Corporation’s basic financial statements including the notes thereto, which follow this section.

Financial Highlights

- During 2014, the Corporation implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. As a result of the implementation of Statement No. 65, (i) the deferred bond issue cost was adjusted against the beginning balance of the net position (deficit); and (ii) the deferred loss and gain from bond refundings is presented as a deferred outflow of resources and deferred inflow of resources, respectively, both excluded from the bonds and notes payable caption. The financial information included in the Management’s Discussion and Analysis was adjusted to reflect the impact of the implementation of Statement No. 65.
- Net deficit in the statement of net position (deficit) increased to $5,474.5 million at June 30, 2014 from $4,535.2 million (as adjusted) at June 30, 2013. The increase in net deficit is mainly due to interest expense on Sales Tax Revenue Bonds and other expenses, of approximately $939.3 million.
- Receipt of Sales and Use Tax increased to $643.7 million in fiscal year 2014 from $619 million in fiscal year 2013, an increase of $24.7 million. This increase was due to a statutory rate increase of 4% provided by Act No. 91, as amended. See note 1 to the basic financial statements.

Overview of the Financial Statements

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

Required Financial Statements

- The statement of net position (deficit) provides information about the nature and amounts of resources (assets) and the Corporation’s obligations (liabilities).
- Current year revenues and expenses are accounted for in the statement of activities. This statement measures the results of the Corporation’s operations over the past year.
- Governmental funds’ financial statements present the financial position and results of operations of the Corporation’s two governmental fund types using a current financial resources measurement focus. The statement of revenues, expenditures, and changes in fund balances can be used to determine, for example, whether and how the Corporation met its debt service requirements for the year.

Financial Analysis

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

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

Government-Wide Financial Analysis

The government-wide financial statements were designed so that the user could evaluate the Corporation's financial condition at the end of the year. The following is a condensed summary of net position (deficit) for the Corporation at June 30, 2014 and 2013(in thousands):

	June 30		Change	
	2014	**2013** (as adjusted)	**Amount**	**Percent**
Assets:				
Receivable from Commonwealth of Puerto Rico	$ 10,997,814	11,889,395	(891,581)	(7.5)%
Other assets	436,590	517,915	(81,325)	(15.7)
Total assets	11,434,404	12,407,310	(972,906)	(7.8)
Total deferred outflow of sources	103,172	103,179	(7)	—
Liabilities:				
Accounts payable and other	268,553	262,819	5,734	2.2
Liabilities payable from restricted assets	16,640,869	16,677,829	(36,960)	(0.2)
Total liabilities	16,909,422	16,940,648	(31,226)	(0.2)
Total deferred inflow of sources	102,617	104,997	(2,380)	(2.3)
Net position (deficit) – unrestricted	$ (5,474,463)	(4,535,156)	(939,307)	20.7%

As noted above, the Corporation's net position (deficit) at June 30, 2014, amounted to $(5,474.5) million, an increase of $939.3 million or 20.7% from $(4,535.2) million at June 30, 2013 (as adjusted). At June 30, 2014, the Corporation had $16,640.9 million of bonds payable outstanding, a decrease of $37 million or 0.2% from $16,677.8 million at June 30, 2013 (as adjusted). As of June 30, 2014 and 2013, the Corporation has accrued $3.4 million to cover for any unfavorable outcome related to a claim in connection with the termination of an interest rate exchange agreements in 2008, refer to note 9 to the basic financial statements.

Condensed revenues, expenses, and change in net position (deficit) for the year ended June 30, 2014 and 2013, are presented below (in thousands):

		June 30		Change	
		2014	**2013** (as adjusted)	**Amount**	**Percent**
Expenses:					
Interest on long-term debt	$	(945,971)	(931,688)	(14,283)	1.5%
Other		(3,254)	(425)	(2,829)	665.6
Total expenditures		(949,225)	(932,113)	(17,112)	1.8
Program revenues:					
Investment earnings		252	357	(105)	(29.4)
Other		9,666	—	9,666	100.0
Total revenues		9,918	357	9,561	2,678.2
Change in net position (deficit)	$	(939,307)	(931,756)	(7,551)	0.8%

Total interest on long term debt for the year ended June 30, 2014 amounted to approximately $946 million, an increase of $14.2 million when compared to 2013. The increase in the interest expense on long-term debt is mainly related to a slight increase in variable-interest rate bonds and the impact of capital appreciation bonds in this caption.

Governmental Fund Financial Analysis

The Corporation's governmental funds reported a total fund balance as of June 30, 2014 and 2013, of $432.2 million and $517 million (as adjusted), respectively. The debt service fund is funded with the receipts of Sales and Use Tax and interest thereon. For the years ended June 30, 2014 and 2013, the receipts of Sales and Use Tax amounted to $643.7 million and $619 million, respectively.

Debt Administration

As of June 30, 2014, the Corporation's outstanding bonds balance was $16,640.9 million, after taking into account unamortized bond premium of $86.3 million, and unaccreted discount of $112.6 million. As of June 30, 2013, the Corporation's outstanding bonds and note balance was $16,677.9 million, after taking into account unamortized bond premium of $89.8 million, and unaccreted discount of $115 million. The bonds are payable in various dates through fiscal year 2058.

On September 30, 2013, Standard & Poor's Ratings Services (S&P) lowered its outlook on the Commonwealth's COFINA Sales Tax Revenue Bonds, Senior Series, and COFINA Sales Tax Revenue Bonds, First Subordinate Series, from stable to negative. S&P, however, maintained the current ratings of "AA-" and "A+", respectively, for the Senior and Subordinated bonds. On October 3, 2013, Moody's lowered its rating on the Commonwealth's COFINA Sales Tax Revenue Bonds Senior Series from "Aa3" to "A2", and affirmed its rating on the Commonwealth's COFINA Sales Tax Revenue Bonds, First Subordinate Series at "A3".

On February 4, 2014, S&P maintained its "AA-" and "A+" ratings on the senior and subordinate bonds of COFINA. S&P kept all of these ratings on "CreditWatch" with negative implications, and noted that further downgrades were possible.

On February 10, 2014, Fitch Ratings (Fitch) maintained its "AA-" and "A+" ratings on COFINA's senior and subordinate bonds. Fitch removed the downgraded bonds from Rating Watch negative but maintained its Rating Outlook negative on these bonds.

Request for Information

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

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

Governmental Funds Balance Sheet and Statement of Net Position (Deficit)

June 30, 2014

	Governmental funds balance sheet				Statement of
	General fund	Debt Service fund	Total	Adjustments	net position (deficit)
Assets:					
Interest-bearing deposits with the Government Development Bank for Puerto Rico	$ 9,600,319	18,787,974	28,388,293	—	28,388,293
Receivable from the Commonwealth of Puerto Rico	—	10,997,813,838	10,997,813,838	—	10,997,813,838
Cash held by trustee	—	4,480	4,480	—	4,480
Accrued interest receivable	—	29	29	—	29
Other receivables	—	656,922	656,922	—	656,922
Investments	170,197	407,370,434	407,540,631	—	407,540,631
Total assets	9,770,516	11,424,633,677	11,434,404,193	—	11,434,404,193
Deferred outflows of resources:					
Accumulated decrease in fair value of hedging derivative	—	—	—	56,530,056	56,530,056
Deferred loss on bonds refunding	—	—	—	46,642,278	46,642,278
Total deferred outflows of resources	—	—	—	103,172,334	103,172,334
Liabilities:					
Accounts payable and accrued liabilities	4,329,155	90,667	4,419,822	3,400,000	7,819,822
Accrued interest payable	—	—	—	204,203,890	204,203,890
Interest rate swap liability	—	—	—	56,530,056	56,530,056
Unearned revenue – Sales and Use Tax	—	10,997,813,838	10,997,813,838	(10,997,813,838)	—
Bonds and notes payable in more than one year – net	—	—	—	16,640,869,248	16,640,869,248
Total liabilities	4,329,155	10,997,904,505	11,002,233,660	5,907,189,356	16,909,423,016
Deferred inflows of resources:					
Deferred gain on bond refundings	—	—	—	102,616,936	102,616,936
Fund balance/net position (deficit):					
Fund balance:					
Restricted	—	426,729,172	426,729,172	(426,729,172)	—
Assigned	5,441,361	—	5,441,361	(5,441,361)	—
Total fund balance	5,441,361	426,729,172	432,170,533	(432,170,533)	—
Total liabilities and fund balance	$ 9,770,516	11,424,633,677	11,434,404,193		
Net position (deficit):					
Unrestricted				(5,474,463,425)	(5,474,463,425)
Net position (deficit)				$ (5,474,463,425)	(5,474,463,425)

See accompanying notes to basic financial statements.

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

Reconciliation of Governmental Funds Balance Sheet to the
Statement of Net Position (Deficit)

June 30, 2014

Total fund balances – governmental funds:	$	432,170,533
Amounts reported for governmental activities in the statement of net position (deficit) are different because:		
Deferred outflows of resources do not constitute current financial resources and, therefore, are not reported in the funds		56,530,056
Accrued interest payable is not due and payable in the current period, and, therefore, is not reported in the fund financial statements		(204,203,890)
Contingent liabilities are not due and payable in the current period, and, therefore, are not reported in the fund financial statements		(3,400,000)
Bonds and notes payable are not due and payable in the current period, and, therefore, are not reported in the funds financial statements		(16,640,869,248)
Deferred loss on bond refundings is not reported as an expenditure in the governmental fund financial statements; however, such loss is deferred and amortized over the remaining life of the refunded bonds		46,642,278
Deferred gain on bond refundings is not reported as revenue in the governmental fund financial statements; however, such gain is deferred and amortized over the remaining life of the refunded bonds		(102,616,936)
Interest rate swap liability is not due and payable in the current period, and therefore, is not reported in the funds financial statements		(56,530,056)
Receivable from the Commonwealth does not constitute current financial resources, and, therefore, is unearned in the fund financial statements		10,997,813,838
Net position (deficit) of governmental activities	$	(5,474,463,425)

See accompanying notes to basic financial statements.

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

Governmental Funds Statement of Revenues,
Expenditures, and Changes in Fund Balance and Statement of Activities

Year ended June 30, 2014

	Statement of governmental funds revenue, expenditures, and changes in fund balances				
	General fund	**Debt service fund**	**Total**	**Adjustments**	**Statement of activities**
Expenditures/expenses:					
General government:					
Payment of obligations of the Commonwealth of Puerto Rico	$ 84,880,328	—	84,880,328	(84,880,328)	—
Other	211,007	42,964	253,971	—	253,971
Debt service:					
Principal	—	333,300,000	333,300,000	(333,300,000)	—
Interest	—	649,751,659	649,751,659	296,219,950	945,971,609
Other	—	2,999,700	2,999,700	—	2,999,700
Total expenditures/expenses	85,091,335	986,094,323	1,071,185,658	(121,960,378)	949,225,280
Program revenues:					
Payments from Commonwealth of Puerto Rico – Sales and Use Tax	—	643,731,051	643,731,051	(643,731,051)	—
Investment earnings	8,784	243,287	252,071	—	252,071
Other income	—	9,665,760	9,665,760	—	9,665,760
Total revenues	8,784	653,640,098	653,648,882	(643,731,051)	9,917,831
Net program expenses	(85,082,551)	(332,454,225)	(417,536,776)	(521,770,673)	(939,307,449)
Other financing sources (uses):					
Proceeds from the Commonwealth of Puerto Rico to repay bond anticipation notes	—	332,700,000	332,700,000	(332,700,000)	—
Transfers in (out)	41,641,844	(41,641,844)	—	—	—
Total other financing sources (uses)	41,641,844	291,058,156	332,700,000	(332,700,000)	—
Excess (deficiency) of revenues and other financing sources over expenditures and other financing uses	(43,440,707)	(41,396,069)	(84,836,776)	84,836,776	—
Change in net position (deficit)	—	—	—	(939,307,449)	(939,307,449)
Fund balance/net position (deficit):					
At beginning of year	48,882,068	468,125,241	517,007,309	(4,869,905,118)	(4,352,897,809)
Effect of adoption of GASB Statement No. 65 (see note 2)	—	—	—	(182,258,167)	(182,258,167)
At beginning of year, as adjusted	48,882,068	468,125,241	517,007,309	(5,052,163,285)	(4,535,155,976)
At end of year	$ 5,441,361	426,729,172	432,170,533	(5,906,633,958)	(5,474,463,425)

See accompanying notes to basic financial statements.

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

Reconciliation of Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities

Year ended June 30, 2014

Net changes in fund balances – total governmental funds:	$	(84,836,776)
Amounts reported for governmental activities in the statement of activities are different because:		
Repayment of long-term debt is reported as an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net position (deficit)		333,300,000
Net change in interest payable reported in the statement of activities does not require the use of current financial resources and, therefore, is not reported as expenditure in the governmental funds		1,101,283
Accretion on capital appreciation bonds does not require the use of current financial resources and, therefore, is not reported as expenditure in the governmental funds		(297,477,976)
Payments from the Commonwealth of Puerto Rico – Sales and Use Tax provide current financial resources to governmental funds; however, represent repayments of the receivable from the Commonwealth of Puerto Rico in the statement of activities		(643,731,051)
Proceeds from the Commonwealth of Puerto Rico to repay bond anticipation notes provide current financial resources to governmental funds; however, represent repayments of the receivable from the Commonwealth of Puerto Rico in the statement of activities		(332,700,000)
Payments of obligations of the Commonwealth of Puerto Rico in exchange for future collections of Sales and Use Tax constitute secured borrowing transactions recorded as receivable from Commonwealth of Puerto Rico in the statement of net position (deficit)		84,880,328
The amortization of bond discount/premium, and gain/loss on bond defeasance do not require the use of current financial resources and, therefore, are not reported as revenues/expenditures in governmental funds:		
Amortization of bond discount/premium		1,137,436
Amortization of gain/loss on bonds defeased		(980,693)
Change in net position (deficit) of governmental activities	$	(939,307,449)

See accompanying notes to basic financial statements.

(1) Reporting Entity

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

The Commonwealth imposes a sales and use tax on a broad range of goods and services. The total tax imposed is 7% and is allocated as follows: 6% for the benefit of the Commonwealth (the Commonwealth Sales Tax), and 1% for the municipalities of the Commonwealth.

Act No. 91 established the Dedicated Sales Tax Fund, a special fund held and owned by the Corporation separate and apart from the Commonwealth's General Fund. Act No. 91 requires that the following amounts be deposited in the Dedicated Sales Tax Fund in each fiscal year, whichever is greater: (i) a minimum fixed amount, referred to in Act No. 91 as the Pledged Sales Tax Base Amount, and (ii) the product of the amount of the Commonwealth Sales Tax collected during such fiscal year multiplied by a fraction, the numerator of which is two point seventy-five percent (2.75%) and the denominator of which is the rate of the Commonwealth Sales Tax (the greater of (i) and (ii) being referred to as the Pledged Sales Tax). In each fiscal year, the first collections of the Commonwealth Sales Tax are deposited in the Dedicated Sales Tax Fund and applied to fund the Pledged Sales Tax Base Amount. The Pledged Sales Tax Base Amount for the fiscal year ended June 30, 2014, was $643,731,051. The Pledged Sales Tax Base Amount increases each fiscal year thereafter at a statutory rate of 4% up to $1,850,000,000. Under Act No. 91, the moneys on deposit in the Dedicated Sales Tax Fund may be used for the payment of the Corporation's bonds or satisfaction of the Authorized Uses (as defined below).

During 2009, the Legislative Assembly expanded the purposes of the Corporation. The Corporation is authorized to pay or finance, in whole or in part, or fund, in addition to the 2006 Appropriation Debt: (i) the debt of the Secretary of the Treasury of the Commonwealth (the Secretary of the Treasury) with the Bank in the amount of $1 billion, a portion of the proceeds of which were used to cover the budgetary deficit of the Commonwealth for fiscal year 2009, (ii) certain financing granted to the Secretary of the Treasury by the Bank payable from future Commonwealth general obligation bonds, and any debt of the Commonwealth outstanding as of December 31, 2008, that did not have a source of repayment or was payable from budgetary appropriations, (iii) a portion of the accounts payable to suppliers of the Commonwealth, (iv) operational expenses of the Commonwealth for fiscal years 2009, 2010, 2011, 2012, and 2013, (v) operational expenses of the Commonwealth for fiscal year 2014, to the extent included in the annual budget of the Commonwealth, (vi) the Puerto Rico Economic Stimulus Fund, (vii) the Commonwealth Emergency Fund in order to cover expenses resulting from catastrophic events such as hurricanes or floods, and (viii) the Economic Cooperation and Public Employees Alternatives Fund (all such uses, together with the 2006 Appropriation Debt, the Authorized Uses).

On October 9, 2013, an amendment to Act No. 91 was signed into law which increased from 2.75% to 3.50% the portion of the Pledge Sales Tax deposited in the Dedicated Sales Tax Fund and expanded the Authorized Uses of Corporation's bond proceeds to include, among others, the refinancing of Bond Anticipation Notes and the financing of the Commonwealth's deficit for fiscal years 2013, 2014 and 2015.

Regardless of the level of Commonwealth Sales Tax collections, Act No. 91 requires that in each fiscal year all collections of the Commonwealth Sales Tax be deposited in the Dedicated Sales Tax Fund until an amount equal to the Pledged Sales Tax Base Amount is deposited before any collections of the Commonwealth Sales Tax are deposited in the Commonwealth's General Fund.

(2) Restatement of Net Position (Deficit)

Effective July 1, 2013, the Corporation adopted Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement classifies certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources, and recognizes certain items that were previously reported as assets and liabilities as outflows of resources (expenses or expenditures) or inflows of resources (revenues) or vice versa. This Statement also requires the write-off of any existing deferred debt issuance costs at the time of adoption against beginning net position, and prospectively, any new debt issue costs on bonds or debt issuance immediate expensing.

As a result of the implementation of GASB No. 65, the Corporation charged-off its existing unamortized debt issue costs of approximately $182.2 million against its beginning net position (deficit) as follows:

Net position (deficit), beginning of year	$	(4,352,897,809)
Effect of adoption of GASB Statement No. 65		(182,258,167)
Net position (deficit), beginning of year, as adjusted	$	(4,535,155,976)

(3) Summary of Significant Accounting Policies

The preparation of basic financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of changes in net position (deficit) during the reporting period. Actual results could differ from those estimates.

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

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

(a) Basis of Presentation

The financial activities of the Corporation consist only of governmental activities. For its reporting purposes, the Corporation has combined the fund and government-wide financial statements using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column.

Government-Wide Financial Statements – The statement of net position (deficit) and the statement of activities report information on all activities of the Corporation. The effect of interfund balances has been removed from the statement of net position (deficit). Governmental activities are financed through revenue of the Sales and Use Tax deposited in the Dedicated Sales Tax Fund and other financing sources.

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

- Restricted Net Position – Results when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- Unrestricted Net Position – Consist of net position that do not meet the definition in the preceding category. Unrestricted net position often is designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

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

Governmental Funds Financial Statements – The accounts of the Corporation are organized on the basis of funds, each of which is considered a separate accounting entity. Separate financial statements are provided for governmental funds. Major individual governmental funds are reported as separate columns in the fund financial statements. All funds of the Corporation are major funds.

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

- General Fund – The general fund of the Corporation is used to account for all financial resources, except those required to be accounted for in another fund.
- Debt Service Fund – The debt service fund is used to account for the Sales and Use Tax deposited in the Dedicated Sales Tax Fund for the payment of interest and principal on long-term obligations.

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

- Nonspendable – amounts that cannot be spent because they are either not in a spendable form (such as inventories and prepaid amounts) or are legally or contractually required to be maintained intact.
- Restricted – amounts that can be spent only for specific purposes because of constraints imposed by external providers (such as grantors, bondholders, and higher levels of government), or imposed by constitutional provisions or enabling legislation. Effectively, restrictions may be changed or lifted only with the consent of the resource provider or by constitutional provisions or enabling legislation.
- Committed – amounts that can be spent only for specific purposes determined by a formal action of the government's highest level of decision-making authority. The Corporation's highest decision-making level of authority rests with the Board of Directors. The Corporation did not have any committed resources as of June 30, 2014.
- Assigned – amounts the government intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed (generally executive orders approved by the Corporation's Executive Director).
- Unassigned – amounts that are available for any purpose.

(b) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

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

Governmental Funds Financial Statements – The governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Corporation considers revenues to be available if they are collected within 30 days of the end of the current fiscal year-end. Expenditures generally are recorded when a liability is incurred as under accrual accounting, except that interest on general long-term obligations is generally recognized when paid, and debt service principal expenditures and claims and judgments are recorded only when payment is due. Expenses paid on behalf of the Commonwealth are recorded as an increase in the Receivable from Commonwealth of Puerto Rico in the government-wide financial statements.

Payments from the Commonwealth of Puerto Rico for Sales and Use Tax are recognized as revenue in the fund financial statements upon collection or when the Commonwealth is obligated to make the payments. In the government-wide financial statements, these payments reduce the receivable from the Commonwealth of Puerto Rico. Collections of Sales and Use Tax received after the receivable from the Commonwealth of Puerto Rico has been liquidated should be reported as revenue in the statement of activities.

(c) Budgetary Accounting

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

(d) Investments

Investments are reported at fair value, except for money market instruments with a remaining maturity at the time of purchase of one year or less and investment positions in 2a7 (Securities and Exchange Commission Rule 2a7 of the Investment Company Act of 1940) like external investment pools, which are carried at cost or the pool's share price. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations.

(e) Bond Issue Costs and Premium/Discount on Bonds

Premium (discounts) on bonds are amortized in a systematic manner over the life of the debt in the government-wide financial statements. Premium (discounts) are recognized in the period when the related long-term debt is issued in the governmental funds financial statements, and therefore are not accounted for in subsequent periods. Bond issue costs are expensed as incurred in both government-wide and governmental fund financial statements.

(f) Interfund Transactions

Transfers represent flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the fund making transfers and as other financing sources in the funds receiving transfers.

(g) Refundings

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

(h) Derivative Instruments

The Corporation uses derivative financial instruments to manage the economic impact of fluctuations in interest rates. Derivative instruments are reported at fair value in the statement of net position (deficit).

(i) Deferred Outflows / Inflows of Resources

In addition to assets, the statement of net position (deficit) includes a separate section for deferred outflows / inflows of resources. These separate financial statement elements, deferred outflows / inflows of resources, represent a depletion (expense/expenditure) or accretion (income) of net position (deficit) that applies to future periods and so will not be recognized as an outflow / inflow of resources until then. The following table shows the deferred outflows / inflows of resources elements at June 30, 2014:

Deferred outflows of resources:		
Accumulated decrease in fair value of hedging derivative	$	56,530,056
Deferred loss on bond refundings		46,642,278
	$	103,172,334
Deferred gain on bond refundings	$	102,616,936

(j) Future Accounting Pronouncements

The GASB has issued the following Statements:

- GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27*. This Statement, among other requirements, will bring the effect of Statement 67, *Financial Reporting for Pension Plans-an amendment of GASB No. 25* into the accounting records of the individual agencies, public corporations and municipalities, whose employees participate in the Retirement Systems of the Commonwealth. The Corporation, as well as the other component units of the Commonwealth and the municipalities, are considered “cost-sharing” employers of the Retirement Systems; therefore, a government participating in the Retirement Systems, such as the Corporation, would report its share of the resulting net pension liability from Statement 67 as follows:

- Based on the Corporation's proportion of the collective net pension liability of all the governments participating
- The proportion should be consistent with the method used to assess contributions (percentage of payroll).

The impact of the effects of this Statement on the Corporation's basic financial statements is not expected to be significant as the Corporation currently has no employees participating in the Retirement Systems. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.

- GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations include a variety of transactions referred to as mergers, acquisitions, and transfer of operations. The requirements of this Statement are effective for government combinations and disposals of government operations occurring in financial reporting periods beginning after December 15, 2013, and should be applied on a prospective basis.
- GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. This Statement amends paragraph 137 of Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflow of resources related to pensions be reported at transition only if it is practical to determine all such amounts. The provisions of this Statement should be applied simultaneously with the provisions of Statement No. 68.

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

(4) Deposits

Custodial credit risk is the risk that in the event of bank failure, in this case the Bank, may not return the Corporation's deposits. The Corporation does not have a policy for custodial credit risk. As of June 30, 2014, the Corporation had deposits with the Bank of approximately $28.4 million held in interest bearing accounts and was therefore exposed to custodial credit risk as they were uninsured and uncollateralized.

(5) Investments

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

- U.S. government and agencies obligations
- Certificates of deposit

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

The Corporation's investment policies establish limitations and other guidelines on maturities and amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country. In addition, such policies provide guidelines on the institutions with which investment transactions can be entered into. In addition, the Asset Liability Management Committee (ALCO) of the Bank, in conjunction with the board of directors of the Corporation will determine, from time to time, other transactions that the Corporation may enter into.

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

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The Corporation's investment policies also provide that the Bank's ALCO is responsible for implementing and monitoring the interest rate risk policies and strategies. The Bank's ALCO meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and interest sensitive liabilities, including matching of their anticipated level and maturities, consistent with the corresponding laws and the Board of Director's objectives.

The following table summarizes the type and maturities of investments held by the Corporation at June 30, 2014.

Investment type		Due within one year	After one to 5 years	Total
U.S. Treasury State and Local Government Series (SLGs)	$	28,123,669	—	28,123,669
Corporate debt – General Electric Capital Corp.		22,906,000	—	22,906,000
External investment pools:				
Dreyfus Government Cash Management		355,958,035	—	355,958,035
Puerto Rico Government Investment Trust Fund (PRGITF)		552,927	—	552,927
Total investments	$	407,540,631	—	407,540,631

Investments in external investments pools consist of $552,927 invested in PRGITF, an internal investment pool of the Commonwealth, and $355,958,226 invested in Dreyfus Government Cash Management (Dreyfus) with the Bank of New York Mellon, which is an investment pool registered with the Securities and Exchange Commission.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Corporation's investment policies provide that investment transactions shall be entered into only with counterparties that are rated BBB+/A-1 or better by Standard & Poor's or equivalent rating by Moody's Investors Service (Moody's) or Fitch Ratings (Fitch), depending on the type and maturity of the investment and the counterparty to the transaction. Any exceptions must be approved by the Corporation's board of directors. The investment policies also provide that purchases and sales of investment securities shall be made using the delivery versus payment procedures.

Investments in U.S. Treasury SLGs carry the explicit guarantee of the U.S. government. As of June 30, 2014, the credit rating of PRGITF, Dreyfus and General Electric Capital Corp. (GE) was AAAm, AAAm, and AA+, respectively, by Standard & Poor's. The investment in PRGITF was held by the Corporation, while the investments in Dreyfus and GE were held by Bank of New York Mellon, as trustee, in the name of the Corporation.

Concentration of Credit Risk – The Corporation places no limits on the amount it may invest in any one issuer. As of June 30, 2014, 6.9% of the Corporation's investments are in U.S. Treasury State and Local Government Series, 5.6% are in corporate debt, and 87.5% are in external investment pools.

(6) Transactions with the Bank and the Commonwealth

The Corporation is a related entity of the Bank. During the year ended June 30, 2014, the Bank provided certain management and administrative services to the Corporation at no cost.

In accordance with Act No. 91, the Corporation incurred expenses on behalf of the Commonwealth amounting to approximately $84.9 million for Authorized Uses.

(7) Bonds and Note Payable

On April 30, 2013, the Corporation issued its Bond Anticipation Note (the BAN), Series 2013A, amounting to approximately $333.3 million. The Series 2013A bear interest at 1.95% and matures on September 30, 2014. The proceeds from the issuance of the Series 2013A were used to complete the funding of the Commonwealth operating budget for the fiscal year 2012-2013. The proceeds from the issuances of bonds prior to fiscal year 2013 were used to refund outstanding debt or for the Authorized Uses as defined in note 1. On March 17, 2014, the BAN Series 2013 A amounting to approximately $333.3 million were redeemed.

As of June 30, 2014, bonds payable of the Corporation consist of the following (in thousands):

Description	Face/effective interest rate		Amount
Sales Tax Revenue Bonds, Series 2007A:			
Capital Appreciation Bonds due from August 1, 2040 to August 1, 2056	4.96%–5.34%	$	2,363,535
Fixed Rate Bonds due on August 1, 2057, including unamortized premium of $14,888	5.25%		578,773
LIBOR-Based Adjustable Rate Bonds due on August 1, 2057	1.11		136,000
Sales Tax Revenue Bonds, Series 2007B:			
Capital Appreciation Bonds due from August 1, 2027 to August 1, 2032	6.20%–6.25%		225,413
Fixed Rate Bonds due from August 1, 2036 to August 1, 2057, net of unaccreted discount of $2,579	6.05%–6.35%		1,183,421
Sales Tax Revenue Bonds, Series 2007C:			
Capital Appreciation Bonds due from August 1, 2022 to August 1, 2038	6.10%		125,654
Term Bonds due from August 1, 2022 to August 1, 2038	6.00		415,305
Sales Tax Revenue Bonds, Series 2008A:			
Capital Appreciation Bonds due from August 1, 2024 to August 1, 2036	6.23%		359,664
Term Bonds due from August 1, 2027 to August 1, 2038	6.13		488,885
Subtotal carried forward			5,876,650

Description	Face/effective interest rate		Amount
Sales Tax Revenue Bonds, First Subordinate Series 2009A:			
Fixed Rate Bonds due from August 1, 2015 to August 1, 2029, including unamortized premium of $10,034, net of unaccreted discount of $12,018	3.75%–6.13%	$	1,066,387
Term Bonds due from August 1, 2036 to August 1, 2044, including unamortized premium of $15,121, and net of unaccreted discount of $45,218	5.75%–6.50%		1,784,903
Capital Appreciation Bonds due from August 1, 2030 to August 1, 2034	6.88%–7.13%		197,740
Convertible Capital Appreciation Bonds due on August 1, 2030 to August 1, 2032 (1)	6.75%		480,055
Sales Tax Revenue Bonds, First Subordinate Series 2009B:			
Fixed Rate Bonds due from August 1, 2025 to August 1, 2039	6.05%–6.35%		918,920
Capital Appreciation Bonds due from August 1, 2033 to August 1, 2035	7.38%–7.48%		77,469
Convertible Capital Appreciation Bonds due from August 1, 2025 to August 1, 2031 (2)	6.90%–7.00%		292,272
Sales Tax Revenue Bonds, Senior Series 2009C – Fixed Rate:			
Bonds due on August 1, 2057	5.75%		237,875
Sales Tax Revenue Bonds, First Subordinate Series 2010A:			
Fixed Rate Bonds due from August 1, 2016 to August 1, 2040, including unamortized premium of $1,178 and net of unaccreted discount of $2,370	3.38%–5.63%		305,418
Term Bonds due from August 1, 2036 to August 1, 2042, net of unaccreted discount of $23,167	5.38%–5.50%		1,214,173
Capital Appreciation Bonds due from August 1, 2031 to August 1, 2036	6.65%–6.77%		174,077
Convertible Capital Appreciation Bonds due on August 1, 2029 to August 1, 2033 (3)	6.13%–6.25%		196,716
Subtotal carried forward			12,822,655

(1) Convertible to fixed-rate interest bonds on August 1, 2016.
(2) Convertible to fixed-rate interest bonds on August 1, 2016 and August 1, 2020 for bonds maturing on August 1, 2030 and 2031.
(3) Convertible to fixed-rate interest bonds on August 1, 2019.

Description	Face/effective interest rate		Amount
Sales Tax Revenue Bonds, First Subordinate Series 2010C:			
Fixed Rate Bonds due from August 1, 2035 to August 1, 2041, including unamortized premium of $14,394 and net of unaccreted discount of $793	5.13%–6.50%	$	464,816
Term Bonds due from August 1, 2033 to August 1, 2041, net of unaccreted discount of $23,033	5.00%–5.50%		1,047,437
Capital Appreciation Bonds due from August 1, 2037 to August 1, 2039	6.63%		127,139
Sales Tax Revenue Bonds, First Subordinate Series 2010D – Fixed Rate Bonds due on August 1, 2042	5.75%		89,435
Sales Tax Revenue Bonds, First Subordinate Series 2010E – Fixed Rate Bonds due on August 1, 2042	5.75%		92,755
Sales Tax Revenue Bonds, First Subordinate Series 2011A-1:			
Fixed Rate Bonds due on August 1, 2043, including unamortized premium of $2,619 and net of unaccreted discount of $2,650	5.00%–5.25%		354,999
Capital Appreciation Bonds due from August 1, 2023 to August 1, 2041	5.25%–6.50%		49,372
Sales Tax Revenue Bonds, First Subordinate Series 2011A-2 Capital Appreciation Bonds due from August 1, 2043 to August 1, 2050	7.00%		404,211
Sales Tax Revenue Bonds, First Subordinate Series 2011B:			
Fixed Rate Bonds due from August 1, 2031 and August 1, 2036	5.00%–5.15%		45,620
Sales Tax Revenue Bonds, Senior Series 2011C:			
Fixed Rate Bonds due from August 1, 2020 to August 1, 2039, including unamortized premium of $13,797 and net of unaccreted discount of $738	4.00%–5.00%		193,989
Term Bonds due from August 1, 2040 and August 1, 2046, including unamortized premium of $14,229	5.00%–5.25%		737,984
Capital Appreciation Bonds due from August 1, 2034 to August 1, 2041	6.15%–6.25%		119,303
Sales Tax Revenue Bonds, Senior Series 2011D:			
Fixed Rate Bonds due on August 1, 2023	3.80%		45,000
Term Bonds due from August 1, 2025 and August 1, 2036	4.10%–4.85%		46,155
Bonds payable – net		$	16,640,870

All term bonds have fixed interest rates.

Bonds and note payable activity for the year ended June 30, 2014 is as follows (in thousands):

Description	Balance at June 30, 2013 (as restated) see note 2	Additions	Reductions	Balance at June 30, 2014
Notes payable	$ 333,300	—	(333,300)	—
Bonds payable	11,474,555	—	—	11,474,555
Capital appreciation bonds – principal	23,716,216	—	—	23,716,216
Discount on capital appreciation bonds	(18,821,074)	297,479	—	(18,523,595)
Less:				
Unamortized bond premium (discount), net	(25,169)	—	(1,137)	(26,306)
Bonds and note payable – net	$ 16,677,828	297,479	(334,437)	16,640,870

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

As of June 30, 2014, debt service requirements for bonds outstanding were as follows:

Year ending June 30	Principal	Interest	Interest subsidy (1)	Total
2015	$ —	647,562,054	(3,834,522)	643,727,532
2016	11,300,000	647,350,178	(3,834,522)	654,815,656
2017	38,295,000	674,289,879	(3,834,522)	708,750,357
2018	18,745,000	693,590,212	(3,834,522)	708,500,690
2019	47,950,000	692,042,637	(3,834,522)	736,158,115
2020-2024	660,200,000	3,523,785,649	(19,172,612)	4,164,813,037
2025-2029	1,726,105,000	3,306,963,096	(19,172,612)	5,013,895,484
2030-2034	3,287,840,000	2,815,884,134	(19,172,612)	6,084,551,522
2035-2039	5,204,020,000	2,187,579,235	(19,172,612)	7,372,426,623
2040-2044	7,672,600,000	987,867,795	(12,462,199)	8,648,005,596
2045-2049	6,545,505,091	326,145,499	—	6,871,650,590
2050-2054	5,525,061,575	313,364,874	—	5,838,426,449
2055-2058	4,453,149,582	211,861,777	—	4,665,011,359
	35,190,771,248	$ 17,028,287,019	(108,325,257)	52,110,733,010
Plus (less):				
Unamortized premium	86,261,609			
Unaccreted discount	(112,567,813)			
Unaccreted interest	(18,523,595,796)			
Bonds payable – net	$ 16,640,869,248			

(1) Sales Tax Revenue Bonds, First Subordinate Series 2010D and 2010E were issued as Build America Bonds. The Corporation will receive a subsidy payment from the federal government equal to 35% and 45%, respectively, of the amount of each interest payment. On June 24, 2013, the IRS sent notice that 8.7% of the subsidy payment on the Build America Bonds will be sequestered due to adjustments on the Federal Government budget.

At June 30, 2014, the Corporation has $136,000,000 of LIBOR based adjustable-rate bonds maturing on August 1, 2057. As explained below, the Corporation has entered into a $136,000,000 interest rate swap, whereby it receives the same rate paid on the adjustable rate bonds and pays a fixed rate of 4.92% through August 1, 2057. Accordingly, the Corporation has synthetically fixed the interest rate on the adjustable rate bonds. Assuming the rate effective as of June 30, 2014 remains the same, debt service requirements for the adjustable rate bonds and net swap payments for their term, are as follows:

	Adjustable-rate bonds		Interest rate	
Year ending June 30	**Principal**	**Interest**	**swap, net**	**Total**
2015	$ —	1,481,176	5,210,024	6,691,200
2016	—	1,470,024	5,221,176	6,691,200
2017	—	1,470,024	5,221,176	6,691,200
2018	—	1,470,024	5,221,176	6,691,200
2019	—	1,470,024	5,221,176	6,691,200
2020-2024	—	7,350,120	26,105,880	33,456,000
2025-2029	—	7,350,120	26,105,880	33,456,000
2030-2034	—	7,350,120	26,105,880	33,456,000
2035-2039	—	7,350,120	26,105,880	33,456,000
2040-2044	—	7,350,120	26,105,880	33,456,000
2045-2049	—	7,350,120	26,105,880	33,456,000
2050-2054	—	7,350,120	26,105,880	33,456,000
2055-2058	136,000,000	6,615,108	23,495,292	166,110,400
Total	$ 136,000,000	65,427,220	232,331,180	433,758,400

The amount deposited each year in the Dedicated Sales Tax Fund is pledged for the payment of the Corporation's bonds payable. The minimum amount to be deposited is the Sales and Use Tax Base Amount, which for the fiscal year ended June 30, 2014, was $643,731,051. The Sales and Use Tax Base Amount increases each fiscal year at a statutory rate of 4% up to $1,850,000,000. At June 30, 2014, the Sales and Use Tax Base Amount, by year, is as follows:

Year ending June 30		Amount
2015	$	669,480,293
2016		696,259,504
2017		724,109,885
2018		753,074,280
2019		783,197,251
2020-2024		4,411,730,898
2025-2029		5,367,545,202
2030-2034		6,530,439,448
2035-2039		7,945,278,109
2040-2044		9,184,724,887
2045-2049		9,250,000,000
2050-2054		9,250,000,000
2055-2058		7,400,000,000
	$	62,965,839,757

On September 30, 2013, Standard & Poor's Ratings Services (S&P) lowered its outlook on the Commonwealth's COFINA Sales Tax Revenue Bonds, Senior Series, and COFINA Sales Tax Revenue Bonds, First Subordinate Series, from stable to negative. S&P, however, maintained the current ratings of AA- and A+, respectively, for the bonds. On October 3, 2013 Moody's lowered its rating on the Commonwealth's COFINA Sales Tax Revenue Bonds, Senior Series from "Aa3" to "A2", and affirmed its rating on the Commonwealth's COFINA Sales Tax Revenue Bonds, First Subordinate Series at "A3".

On February 4, 2014, S&P maintained its "AA-" and "A+" ratings on the senior and subordinate bonds of Puerto Rico Sales Tax Financing Authority (COFINA). S&P kept all of these ratings on "CreditWatch" with negative implications, and noted that further downgrades were possible.

On February 10, 2014, Fitch maintained its "AA-" and "A+" ratings on COFINA's senior and subordinate bonds. Fitch removed the downgraded bonds from Rating Watch negative but maintained its Rating Outlook negative on these bonds.

On November 23, 2011, the Corporation issued $397.7 million Series 2011A-1 bonds. Part of the proceeds from the Series 2011A-1 bonds was used to advance refund part of the outstanding Series 2009 A bonds aggregating $52,780,000 and bearing interest ranging from 4.00% to 6.125%. The Corporation used approximately $65,867,000 from the net proceeds of the issued Series 2011A-1 bonds and other funds to purchase U.S. government securities, which were deposited in an irrevocable trust fund with an escrow agent to provide for all future debt services payments of the refunded Series 2009A bonds. On November 23, 2011, the Corporation also issued its Series 2011 B bonds amounting to approximately $45.6 million to advance

(Continued)

refund part of the outstanding Series 2009 B bonds aggregating $38,490,000 and bearing interest at 6.05%. The Corporation used the net proceeds of the issued Series 2011B bonds and other funds to purchase U.S. government securities, which were deposited in an irrevocable trust fund with an escrow agent to provide for all future debt services payments of the refunded Series 2009 B bonds. Accordingly, the Series 2009A and the Series 2009B refunded bonds are considered to be defeased and the liabilities have therefore been removed from the statement of net position. As a result of these advance refundings, the Corporation expects to increase its total debt service requirements by approximately $34.3 million over the next 25 years and will incur an economic loss (the difference between the present values of the debt service payments of the refunded bonds and the refunding bonds) of approximately $4.7 million. The outstanding balance of the advance refunded bonds was $91,270,000 at June 30, 2014.

(8) Derivative Instruments

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

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

Credit risk is the failure of the counterparty (or its guarantor) to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes the Corporation, which creates credit risk for the Corporation. When the fair value of a derivative contract is negative, the Corporation owes the counterparty and, therefore, does not possess credit risk. The Corporation minimizes the credit risk in derivative instruments by entering into transactions with counterparties whose credit rating is acceptable under the investment policies of the Corporation. At June 30, 2014, there is no credit risk since the fair value of derivative instrument is negative.

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

The Corporation has entered into an interest rate exchange agreement (swap) with a counterparty in connection with the issuance of LIBOR-Based Adjustable Rate Bonds within the Sales Tax Revenue Bonds Series 2007A (the Adjustable Rate Bonds). The Adjustable Rate Bonds expose the Corporation to variability in interest payments due to changes in interest rates. Management believes that it is prudent to limit the variability of interest payments on the Adjustable Rate Bonds. To meet this objective, management entered into an interest rate swap agreement to manage fluctuations in cash flows resulting from interest rate risk. This swap effectively changes the variable rate cash flow exposure on the Adjustable Rate Bonds to fixed cash flows. Under the terms of the interest rate swap, the Corporation receives variable interest rate payments equal to the interest payment on the Adjustable Rate Bonds, and makes fixed interest rate payments, thereby creating the equivalent of a fixed rate debt. At June 30, 2014, the credit rating of the counterparty to this swap agreement was A-1 by Standard & Poor's.

The fair value and notional amount of the derivative instrument outstanding at June 30, 2014, classified by type, was as follows:

Notional amount	Fair value	Change in Fair value	Floating rate indicator	Maturity date	Receives Type	Receives Rate	Pays Type	Pays Rate	Cash outflows
(In thousands)									(In thousands)
Hedging derivative instrument:									
$ 136,000	$ 56,530	3,354	67% of 3m LIBOR plus 0.93	8/1/2057	Variable	1.089%	Fixed	4.920%	5,194

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

(9) Contingency

In connection with the termination of an interest rate exchange agreement (swap) with a notional amount of $218 million by the Corporation relating to its Sales Tax Revenue Bonds, Series 2007A, the Corporation made a termination payment to the counterparty in November 2008. The counterparty subsequently asserted that it is entitled to a termination payment in excess of that paid by the Corporation in November 2008, plus interest at a default rate, amounting to approximately $64.0 million as of fiscal year end 2011. The counterparty alleged that the date of the termination notice used by the Corporation for purposes of calculating the termination payment was not in accordance with the agreement. In addition, the counterparty alleged that the termination payment should have been based on the value of replacement swaps entered into by the Corporation, which actually have different credit terms than those contained in the terminated swap.

During the year ended June 30, 2011, the Corporation accrued $3.4 million in connection with this matter. This amount is presented as accounts payables and accrued liabilities in the accompanying statement of net position (deficit).

The Corporation intends to contest this matter vigorously. Among other things, it is the opinion of the Corporation's management that, even assuming that the counterparty's allegations regarding improper termination are correct, the amounts claimed by the counterparty are not correct. Accordingly, management does not expect that the ultimate costs to resolve this matter will have a material adverse effect on its financial position or results of operations.

(10) Subsequent Events

In connection with the Swap Agreement with Goldman Sachs (GS) described in note 8, on July 1, 2014 Moody's issued a downgrade on the LIBOR 2007A Bonds to a rating of Ba3. On September 24, 2014, rather than terminate the Swap Agreement, the Corporation and GS entered into a new credit annex (the "2014 Credit Support Annex") as well as an Amendment to the ISDA Master Agreement (the "2014 ISDA Amendment") to permit the Corporation to collateralize its obligations under the Swap Agreement and to amend the termination events thereunder. The impact of the new agreement was for the Corporation to post $12 million in collateral to GS, as well as set up a restricted account in which a portion of the collateral be deposited for the benefit of GS.

During the second semester of the fiscal year 2014-15, COFINA has been subject to certain credit downgrades by the major credit rating agencies. The following table summarizes such downgrades:

Agency	Date of downgrade	Sales Tax Revenue Bonds (Senior Lien)		Sales Tax Revenue Bonds First Subordinate (Senior Lien)	
		To	From	To	From
Moody's	05/21/15	Caa2	B3	Caa3	Caa1
	02/19/15	B3	Ba3	Caa1	B1
S&P	04/24/15	CCC+	B	CCC+	B
	02/12/15	B	BBB	B	BBB-
Fitch	03/26/15	B	BB-	B	BB-

Effective on July 1, 2015, the Commonwealth Sales Tax will increased from a current 6% to a 10.5%, as required by Act No. 72 of May 29, 2015, an amendment to the Puerto Rico Internal Revenue Code of 2011, (the Act No. 72). The Act No. 72 also imposes a Commonwealth Sales Tax of 4% to professional and business-to-business services rendered after September 30, 2015 until April 1, 2016.

The Act No. 72 serves as a bridge mechanism between the actual Sales and Use Tax to an integrated new tax reform. As per Act No. 72, the new tax reform should incorporate certain virtues of the general excise tax and the actual Sales and Use Tax to reach a Value-Added Tax (IVA, by its Spanish acronym) as the desirable consumption tax for Puerto Rico. Such tax reform will emerge from the recommendations presented by the Alternatives for the Consumption Tax Transformation Commission.