



**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Financial Statements and Required Supplementary Information

June 30, 2013

(With Independent Auditors' Report Thereon)

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

**Table of Contents**

	<b>Page(s)</b>
Independent Auditors' Report	1 – 3
Management's Discussion and Analysis (Unaudited)	4 – 9
Basic Financial Statements:	
General Fund Balance Sheet and Statement of Net Position	10
Statement of General Fund Revenue, Expenditures, and Changes in Fund Balance and Statement of Activities	11
Notes to Financial Statements	12 – 26
Required Supplementary Information	
Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual – Non-GAAP Budgetary Basis (General Fund)	27
Notes to Required Supplementary Information	28



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## **Independent Auditors' Report**

The Comptroller of Puerto Rico  
Office of the Comptroller:

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities and General Fund of the Office of the Comptroller of the Commonwealth of Puerto Rico (the Office), an agency of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the Office'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 and the standards applicable to financial audits contained in the *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 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 respective financial position of the governmental activities and General Fund of the Office of the Comptroller of the Commonwealth of Puerto Rico as of June 30, 2013, and respective changes in financial position for the year then ended in accordance with U.S. generally accepted accounting principles.

### ***Emphasis of Matters***

#### ***Restatement of Net Position***

As part of our audit of the 2013 basic financial statements, we also audited the adjustments described in note 2 that were applied to restate the net position as of June 30, 2012. The Office's previously issued basic financial statements were audited by other auditors. In our opinion, such adjustments are appropriate and have been properly applied.

#### ***Agency Financial Statements***

As discussed in Note 1, the financial statements of the Office of the Comptroller of the Commonwealth of Puerto Rico are intended to present the financial position and the changes in financial position of only that portion of the governmental activities and general fund of the Commonwealth of Puerto Rico that is attributable to the transactions of the Office. They do not purport to, and do not, present fairly the financial position of the Commonwealth of Puerto Rico as of June 30, 2013, and the changes in its financial position for the year then ended in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

### ***Other Matters***

#### ***Required Supplementary Information***

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 4 through 9 and budgetary comparison information on page 27 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 considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



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

In accordance with *Government Auditing Standards*, we have also issued our report dated November 27, 2013 on our consideration of the Office’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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Office’s internal control over financial reporting and compliance.

KPMG LLP

San Juan, Puerto Rico  
November 27, 2013

Stamp No. E89603 of the Puerto Rico  
Society of Certified Public Accountants  
was affixed to the record copy of this report.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)  
Management's Discussion and Analysis (Unaudited)  
June 30, 2013

The Office of the Comptroller (the Office), an agency assigned to the Legislative Branch of the Commonwealth of Puerto Rico (the Commonwealth), offers to the readers of the financial statements this narrative overview and analysis of the financial activities of the Office for the fiscal year ended June 30, 2013.

**Financial Highlights**

- Total liabilities of the Office at the close of the fiscal year ended June 30, 2013 amounted to approximately \$12,700,000 comprising primarily the accrual for vacations and sick leave in the total amount of approximately \$10,400,000. The liabilities exceeded its assets by approximately \$5,800,000 primarily due to the aforesaid accrual for vacations and sick leave. The Office has the resources to meet its ongoing obligations, and the liabilities for accrued vacations and sick leave will be met with revenues from legislative appropriations in future years as these liabilities become due.
- The Office's total assets increased by approximately \$1,700,000.
- The final budget of the Office for fiscal year 2012-2013 was \$43,000,000.

The Office's revenues and other financing sources exceeded its budgetary basis expenditures by approximately \$960,000 for the fiscal year 2012-2013.

**Overview of the Basic Financial Statements**

This Management's Discussion and Analysis section is intended to serve as an introduction to the Office's basic financial statements. The Office's basic financial statements comprise three components: 1) government-wide financial statements on all of the activities of the Office, 2) fund financial statements, and 3) notes to basic financial statements.

***Government-Wide Financial Statements***

The government-wide financial statements are designed to provide readers with a broad overview of the Office's financial position, in a manner similar to a private-sector business.

The statement of net position presents information of all of the Office's assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the Office is improving or deteriorating as a result of the year's operations.

The statement of activities presents information showing how the Office's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Both of the government-wide financial statements distinguish functions of the Office that are supported by appropriations from the General Fund of the Commonwealth. The Office has the constitutional duty to ascertain that all revenues, accounts, and disbursements of the Commonwealth and all operations involving public funds and public property were performed as stated in Article III of the Constitution of the Commonwealth, Act No. 9 of July 24, 1952, as amended.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)  
Management's Discussion and Analysis (Unaudited)  
June 30, 2013

***Fund Financial Statements***

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Office, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The General Fund of the Office belongs to the category of governmental funds.

Governmental funds are used to account for essentially the same functions reported as governmental activities in the government-wide financial statements. However, unlike the government-wide financial statements, fund financial statements focus on near-term inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental fund financial statements is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both, the General Fund balance sheet and the statement of General Fund revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The Office maintains one individual governmental fund and adopts an annual appropriated budget for its General Fund. A budgetary comparison schedule has been provided for the General Fund to demonstrate compliance with this budget.

***Notes to Financial Statements***

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 12 to 26 of this report.

**Financial Analysis of the Governmental Activities**

As noted earlier, the Office uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)  
Management's Discussion and Analysis (Unaudited)  
June 30, 2013

***Net Position***

The statement of net position serves as an indicator of the Office's financial position at the end of fiscal year. The Office's net position increased by approximately \$680,000 over the course of fiscal year 2013. The Office's net position includes investment in capital assets for approximately \$2,100,000 and a deficit of approximately \$7,900,000. The following is condensed summary information for fiscal years ended June 30, 2013 and 2012.

	<b>Condensed summary information of net position</b>		
	<b>2013</b>	<b>2012</b>	<b>Change</b>
		<b>(as restated)</b>	
Current assets	\$ 4,818,059	3,269,175	1,548,884
Capital assets, net	2,093,113	1,973,110	120,003
Total assets	<u>\$ 6,911,172</u>	<u>5,242,285</u>	<u>1,668,887</u>
Current liabilities	\$ 1,629,173	324,370	1,304,803
Noncurrent liabilities	11,089,702	11,405,954	(316,252)
Total liabilities	<u>\$ 12,718,875</u>	<u>11,730,324</u>	<u>988,551</u>
Net position:			
Net investment in capital assets	\$ 2,093,113	1,973,110	120,003
Unrestricted – deficit	(7,900,816)	(8,461,149)	560,333
Total net position	<u>\$ (5,807,703)</u>	<u>(6,488,039)</u>	<u>680,336</u>

The Office restated the beginning balance of net position reported at June 30, 2012 to increase capital assets by approximately \$84,000, accrued Christmas bonus by approximately \$702,000 and accrued compensated absences by approximately \$1,200,000.

Total assets of the Office's at June 30, 2013 increased by approximately \$1,700,000 when compared to the total assets as of June 30, 2012 primarily attributable to the continued efforts to protect the fiscal condition that included a reduction in number of employees and payroll expenses and other fiscal controls.

Total liabilities at June 30, 2013 increased by approximately \$989,000 when compared to total liabilities at June 30, 2012. This increase is mainly attributable to the impact of Act No. 3 of April 4, 2013. This law amends the provisions of the different benefits structures under the Employee's Retirement System of the Government of Puerto Rico (ERS) stimulating the retirement of certain employees, effective June 30, 2013.



**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)  
Management's Discussion and Analysis (Unaudited)  
June 30, 2013

***Capital Assets***

The capital assets of the Office are those assets that are used in the performance of its functions. The net investment in capital assets for the fiscal year ended June 30, 2013 amounts to approximately \$2,100,000. The Office's capital assets, net increased during 2013 by approximately \$120,000.

Capital assets, net increased primarily due to the net effect of the following:

- The acquisition of equipment and furniture at a cost of approximately \$290,000.
- Current year's depreciation and amortization of approximately \$598,000
- The acquisition of software including capitalization of internally developed software in the amount of approximately \$498,000.
- The retirement of equipment, electronic equipment, furniture, and software in the net amount of approximately \$69,000.

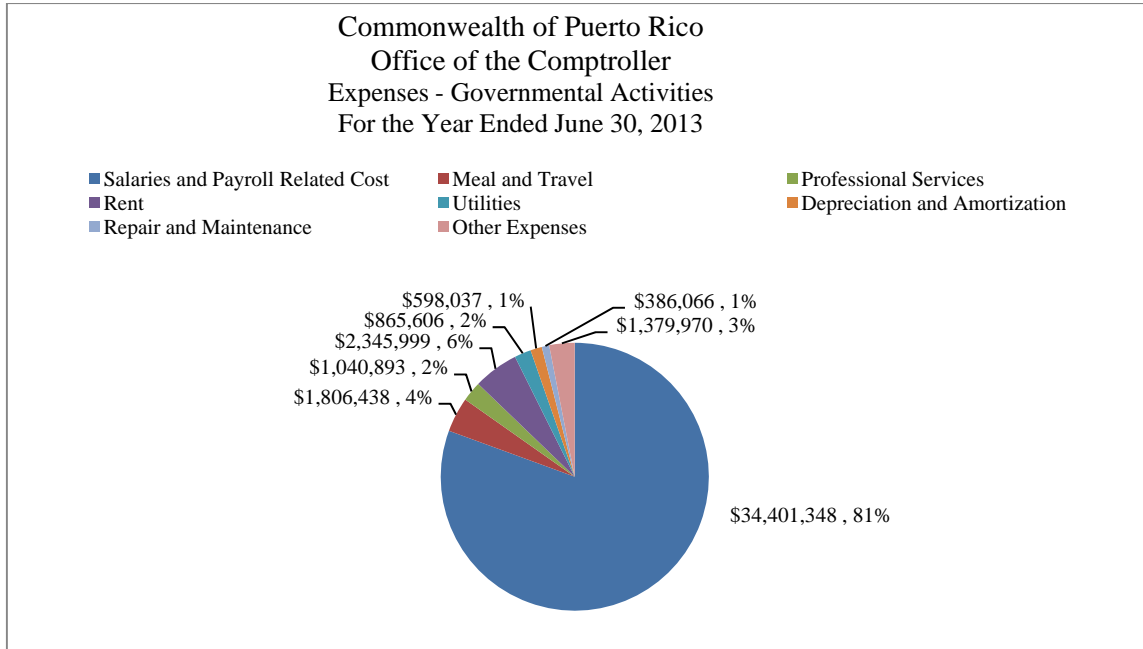
***Changes in Net Position***

The following condensed summary of activities reflects how the Office's net position changed during the fiscal year ended June 30, 2013.

	<u>2013</u>	<u>2012</u>	<u>Change</u>
Revenues	\$ 4,993	—	4,993
Transfers in	43,499,700	43,248,850	250,850
Expenses	<u>(42,824,357)</u>	<u>(42,869,741)</u>	45,384
Change in net position	<u>\$ 680,336</u>	<u>379,109</u>	<u>301,227</u>

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
 (An Agency of the Commonwealth of Puerto Rico)  
 Management's Discussion and Analysis (Unaudited)  
 June 30, 2013

The following chart presents the expenses incurred by the Office during the fiscal year ended June 30, 2013.



The Office's major expense is related to salaries, benefits, and payroll taxes, which represent 81% of total expenses incurred during fiscal year ended June 30, 2013. The increase in transfers in of approximately \$251,000 represents an increase in the annual employer additional contribution of 1% paid by the Office of Management and Budget of the Commonwealth to the ERS.

**General Fund Budgetary Highlights**

The 2012-2013 General Fund Budget was \$43,000,000 and actual expenses in the budgetary basis were \$42,043,207. Total expenditures represented 97.8% of total budget availability for the fiscal year. The Office's expenditure rate presents a similar rate when compared to prior year performance (97.6%).

The following table summarizes the operational results under the non-GAAP budgetary basis of accounting for the fiscal year ended June 30, 2013.

	<u>Actual</u>
Revenue and other financing sources	\$ 43,004,993
Expenditures	<u>42,043,207</u>
Unexpended balance	<u>\$ 961,786</u>
Expenditure rate	97.8%

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)  
Management's Discussion and Analysis (Unaudited)  
June 30, 2013

The operational results present a saving on the assigned budget amounting to approximately \$960,000 for year ended 2013.

**Economic Factors and Next Year's Budget**

The economy of Puerto Rico is closely linked to the United States economy, as most of the external factors that affect the local economy are determined by the policies and performance of the mainland economy. These external factors include exports, direct investment, the amount of federal transfer payments, the level of interest rates, the rate of inflation, and tourist expenditures.

Puerto Rico has experienced mixed results in the service sector, which includes wholesale and retail trade, utilities, transportation and warehousing, information, finance and insurance, real estate and rental, and certain services such as professional, scientific, technical, management, administrative, support, educational, health care, social, recreational, accommodation, food and other services. This sector has expanded in terms of income over the past decade, following the general trend of other industrialized economies, but with differences on the magnitudes of those changes. The development of the service sector has been positively affected by demand generated by other sectors of the economy, such as manufacturing and construction.

According to the Puerto Rico Planning Board's latest projections made in April 2013, which took into account the preliminary results for fiscal year 2012, the estimated effects on the Puerto Rico economy of the United States' budget sequestration, the end of the ARRA funds, the impact of the initial phase of the tax reform, the recent initiatives to promote private employment creation, the end of the local stimulus plan, and other economic factors, it is projected that Puerto Rico's real gross national product for fiscal year 2013 will decrease by 0.4%.

The Office adopted the 2012-2013 fiscal year budget on July 1, 2012. The legislative appropriations for the fiscal year 2013 amounted to \$43,000,000.

**Requests for Information**

This financial report is designed to provide a general overview of the Office of the Comptroller's finances for all those with an interest in the government's finances. Question concerning any of the information provided in this report or requests for additional financial information should be addressed to the Finance and Budget Division, The Office of the Comptroller of the Commonwealth of Puerto Rico, PO Box 366069, San Juan, Puerto Rico 00936-6069.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

General Fund Balance Sheet and Statement of Net Position

June 30, 2013

	<u>General Fund Balance Sheet</u>	<u>Adjustments</u>	<u>Statement of Net Position</u>
<b>Assets:</b>			
Cash in governmental bank	\$ 4,750,854	—	4,750,854
Cash under the custody of the Secretary of Treasury of the Commonwealth of Puerto Rico	7,257	—	7,257
Accounts receivable – employees and other	59,948	—	59,948
<b>Capital assets:</b>			
Non-depreciable	—	581,902	581,902
Depreciable, net	—	1,511,211	1,511,211
Total assets	<u>4,818,059</u>	<u>2,093,113</u>	<u>6,911,172</u>
<b>Liabilities:</b>			
Accounts payable and accrued liabilities	1,629,173	—	1,629,173
Other accrued long-term liabilities, due within one year	—	3,572,855	3,572,855
Other accrued long-term liabilities, due after one year	—	7,516,847	7,516,847
Total liabilities	<u>1,629,173</u>	<u>11,089,702</u>	<u>12,718,875</u>
<b>Fund balance/net position:</b>			
<b>Fund balance:</b>			
Committed	7,257	(7,257)	—
Assigned	51,710	(51,710)	—
Unassigned	3,129,919	(3,129,919)	—
Total fund balance	<u>3,188,886</u>	<u>(3,188,886)</u>	—
Total liabilities and fund balance	<u>\$ 4,818,059</u>		
<b>Net position:</b>			
Net investment in capital assets		2,093,113	2,093,113
Unrestricted		(7,900,816)	(7,900,816)
Net position		<u>\$ (5,807,703)</u>	<u>(5,807,703)</u>

See accompanying notes to financial statements.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Statement of General Fund Revenue,  
Expenditures, and Changes in Fund Balance and Statement of Activities

June 30, 2013

	<b>General Fund Revenue, Expenditures, and Changes in Fund Balance</b>	<b>Adjustments</b>	<b>Statement of Activities</b>
	<u>                    </u>	<u>                    </u>	<u>                    </u>
Expenditures/expenses:			
General government:			
Salaries and payroll-related costs	\$ 34,717,601	(316,253)	34,401,348
Meals and travel	1,806,438	—	1,806,438
Professional services	1,040,893	—	1,040,893
Insurance	41,238	—	41,238
Rent	2,345,999	—	2,345,999
Utilities	865,606	—	865,606
Noncapitalizable equipment	112,037	—	112,037
Materials and supplies	96,391	—	96,391
Repairs and maintenance	386,066	—	386,066
Depreciation and amortization	—	598,037	598,037
Loss on disposition of assets	—	69,286	69,286
Trainings and continuing professional education	196,021	—	196,021
Subscriptions and memberships	97,885	—	97,885
Outsource services:			
Security	234,146	—	234,146
Maintenance	125,092	—	125,092
Other	370,836	—	370,836
Printing services	29,796	—	29,796
Postage	1,771	—	1,771
Miscellaneous	5,471	—	5,471
Capital outlays	787,326	(787,326)	—
Total expenditures/expenses	<u>43,260,613</u>	<u>(436,256)</u>	<u>42,824,357</u>
General revenue – Interest income	4,993	—	4,993
Other financing sources – Transfers in:			
Commonwealth of Puerto Rico appropriations	43,000,000	—	43,000,000
Other Commonwealth of Puerto Rico appropriations under Joint Resolution No. 54, of June 10, 2011	499,700	—	499,700
Total general revenue and transfer-in	<u>43,504,693</u>	<u>—</u>	<u>43,504,693</u>
Excess of revenues and transfers in over expenditures	244,080	(244,080)	—
Change in net position	—	680,336	680,336
Fund balance/net position:			
At beginning of year (as restated, see note 2)	2,944,806	(9,432,845)	(6,488,039)
At end of year	<u>\$ 3,188,886</u>	<u>(8,996,589)</u>	<u>(5,807,703)</u>

See accompanying notes to financial statements.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(1) Organization and Basis of Presentation**

**(a) Organization**

The Commonwealth of Puerto Rico (the Commonwealth) was constituted on July 25, 1952, under the provisions of its Constitution as approved by the People of Puerto Rico and the Congress of the United States of America. The Commonwealth's Constitution provides for the separation of powers of the executive, legislative, and judicial branches of the government. The Commonwealth assumes responsibility for public safety, public health, public housing, welfare, education, and economic development.

The position of Comptroller of Puerto Rico was created by virtue of Article III, Section 22 of the Constitution of the Commonwealth. The Comptroller of Puerto Rico is appointed by the Governor with the consent of the Legislature of the Commonwealth (the Legislature) for a term of 10 years and until his successor has been appointed and qualified.

The function of the Comptroller of Puerto Rico is to audit all the revenues, accounts, and expenditures of the Commonwealth, its agencies and instrumentalities, and its municipalities, in order to determine if they have been made in conformity with the law and to submit the corresponding audit reports. Also, it submits annual reports and all other special reports that are required by the Legislature or the Governor.

The Office of the Comptroller (the Office) was created by Law 9 of July 24, 1952, as amended. The Office is an agency of the Commonwealth, assigned principally to the Legislative Branch of the Commonwealth. The administration of the Office is autonomous and is under the direction of the Comptroller of Puerto Rico.

Effective July 1, 2012, the Office became fiscally autonomous pursuant to the provisions of Act 58 of March 19, 2012. As a result of this Act, the non - committed cash of the Office that was previously under the custody of the Secretary of Treasury of the Commonwealth of Puerto Rico was transferred to the Office. Substantially all expenditures of the Office are disbursed from the Office's bank accounts since that date.

The accompanying basic financial statements of the Office have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

**(b) The Financial Reporting Entity**

The Office is part of the Commonwealth of Puerto Rico. Its financial data is part of the General Fund of the Commonwealth.

The accompanying financial statements are issued solely for the information and use of the Comptroller, the Governor and the Legislature of the Commonwealth and the People of the Commonwealth of Puerto Rico.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

(c) ***Basis of Presentation***

The financial activities of the Office, which consist only of governmental activities, are reported under the general government function in the Commonwealth's basic financial statements. For its reporting purposes, the Office has combined the General 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. A brief description of the Offices' government-wide and fund financial statements is as follows:

*Government-wide Financial Statements:* The government-wide statement of net position and statement of activities report the overall financial activity of the Office. The financial activities of the Office consist only of governmental activities, which are primarily supported by Commonwealth appropriations (transfers in within the General Fund of the Commonwealth).

The statement of activities demonstrates the degree to which the direct expenses of a given function (i.e., general government) are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function. The Office has no program revenues. Revenues that are not classified as program revenues are presented as general revenues.

*Fund Financial Statements:* The fund financial statements provide information about the Office's General Fund. The General Fund accounts for all financial resources of the Office.

The following is a reconciliation between the General Fund balance sheet and the statement of net position at June 30, 2013:

Fund balance	\$	3,188,886
Add capital assets, net of accumulated depreciation, as they are not financial resources and, therefore, are not reported in the General Fund		2,093,113
Less accrued compensated absences and Christmas bonus, as they are not due and payable in the current period and, therefore, are not reported in the General Fund		<u>(11,089,702)</u>
Net position	\$	<u><u>(5,807,703)</u></u>

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

The following is a reconciliation between the excess of revenues and transfers in over expenditures in the statement of General Fund revenues, expenditures, and changes in fund balance, and the change in net position in the statement of activities for the fiscal year ended June 30, 2013:

Excess of revenues and transfers in over expenditures	\$	244,080
Add current year change in compensated absences that are recorded as a long-term liability in the government-wide financial statements		300,541
Add current year change in accrued Christmas bonus that is recorded as a long-term liability in the government-wide financial statements		15,712
Less current year depreciation and amortization, as the cost of assets is allocated over their useful lives in the statement of activities		(598,037)
Less loss on disposal of assets that were not capitalized in the General Fund		(69,286)
Add capital outlays reported as expenditures in the General Fund that are shown as capital assets in the statement of activities		787,326
Change in net position	\$	680,336

**(d) Basis of Accounting**

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

The General Fund, as a governmental fund, is reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. Expenditures generally are recorded when the liability is incurred, as under accrual accounting. However, claims and judgments, and compensated absences are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds.



**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(2) Restatement of Net Position**

The Office restated the beginning balance of net position reported at June 30, 2012, as follows:

	<b>Governmental Activities</b>		
	<b>As previously reported</b>	<b>Adjustments</b>	<b>As restated</b>
Capital assets non-depreciable (a)	\$ 466,601	(39,433)	427,168
Capital assets depreciable (a)	1,422,350	123,592	1,545,942
Accrued Christmas bonus (b)	—	701,892	701,892
Accrued compensated absences (c)	9,498,170	1,205,893	10,704,063
Net position	(4,664,413)	(1,823,626)	(6,488,039)

- (a) Capital assets were adjusted primarily to recognize capitalizable software costs incurred during 2010 when GASB Statement No. 51, *Accounting and Reporting for Intangible Assets*, was effective, and to capitalize payroll related costs on internally developed intangible assets which were previously not recorded.
- (b) The accrued Christmas bonus adjustment represents payroll benefits earned and vested by the employees at June 30, 2012, but due and payable in December 2012. The beginning balance of net position was adjusted to recognize this accrual which was previously not recorded.
- (c) The balance of accrued compensated absences was adjusted at June 30, 2012 to recognize an accrual of non-vested sick leave for those employees considered probable to be eligible in the future to receive such payments which was previously not recorded.

The effect of the errors, had they been corrected in the prior year financial statements, would have increased the change in net position for 2012 by approximately \$648,000, from approximately \$379,000 to approximately \$1,027,000.

**(3) Summary of Significant Accounting Policies**

**(a) Cash**

Certain funds of the Office are under the custody of the Secretary of the Treasury of the Commonwealth pursuant to Act. No. 230 of July 23, 1974, as amended, known as “Commonwealth of Puerto Rico Accounting Law.” The Treasury Department of the Commonwealth follows the practice of pooling cash and cash equivalents under the custody and control of the Secretary of the Treasury (the Cash Pool.)

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

Effective July 1, 2012, Act No. 58 of March 19, 2012 granted the Office the powers and rights of fiscal autonomy. Under Act No. 58, the Office is permitted to maintain and manage its cash accounts separate from the Cash Pool.

**(b) Capital Assets**

Capital assets are reported in the government-wide financial statements of the Office. The Office defines capital assets as assets, which have an initial, individual cost of \$500 or more at the date of acquisition and have a useful life in excess of two years. Capital assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at estimated fair market value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Capital assets are depreciated or amortized using the straight-line method over the assets estimated useful lives. No amortization is recorded for computer software being developed. The estimated useful lives of capital assets being depreciated are as follows:

	<u>Years</u>
Electronic equipment	5
Other equipment	5
Furniture	10
Computer software	5
Vehicles	5–10

**(c) Compensated Absences**

The liability for compensated absences reported in the government-wide financial statements consists of unpaid, accumulated vacation and sick leave balances for Office employees. A liability for these amounts is reported in the General Fund only if they have matured, for example, as a result of employee resignations and retirements. The liability has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary-related costs (e.g., social security and Medicare tax).

The employees of the Office are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation and sick leave may be accumulated in excess of the maximum permitted of sixty (60) and ninety (90) days, respectively. When an employee resigns, the Office accumulated vacation is liquidated. The resignation as a government employee, before consuming the accrued sick leave days, ends all rights to compensation except for those employees with ten (10) or more years of service, which have the right to such compensation up to the maximum allowed.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(d) Fund Balance**

The fund balance for the General Fund is reported in classifications based on the extent to which the Office is bound to honor constraints on the specific purposes for which amounts in the General Fund can be spent.

- Fund balance is reported as nonspendable when the resources cannot be spent because they are either in a nonspendable form or legally or contractually required to be maintained intact. There was no nonspendable fund balance as of June 30, 2013.
- Fund balance is reported as restricted when the constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provision or by enabling legislation. There was no restricted fund balance as of June 30, 2013.
- The Office's highest decision-making level of authority rests with the Commonwealth's Legislature. Fund balance is reported as committed when the Legislature passes a law that places specified constraints on how resources may be used. The law can modify or rescind a commitment of resources through passage of a new law.
- Resources that are constrained by the Office's intent to use them for a specific purpose, but are neither restricted nor committed, are reported as assigned fund balance. Intent may be expressed by the Comptroller.
- Unassigned fund balance represents fund balance that has not been restricted, committed, or assigned and may be utilized by the Office for any purpose. When expenditures are incurred, and both restricted and unrestricted resources are available, it is the Office's policy to use restricted resources first, then unrestricted resources in the order of committed, assigned, and then unassigned, as they are needed.

**(e) Net Position**

Net position represents the difference between assets and liabilities in the government-wide financial statements. Net position is displayed in the following components:

- (i) Net investment in capital assets – This consists of capital assets, less accumulated depreciation and amortization.
- (ii) Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Office's policy to use restricted resources first, then unrestricted resources when they are needed. There was no restricted net position at June 30, 2013.
- (iii) Unrestricted – This consists of net position that does not meet the definition of "restricted" or "net investment in capital assets."

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(f) Commonwealth Appropriations**

The Office operations are financed through appropriations from the Commonwealth of Puerto Rico. These appropriations are recognized as transfers in the General Fund when received.

**(g) Risk Financing**

The Commonwealth of Puerto Rico purchases commercial insurance covering casualty, theft, tort, claims, and other losses for the Office. The Office reimburses the Commonwealth for premium payments made on its behalf. The current Office insurance policies have not been canceled or terminated. For workers' compensation the State Insurance Fund Corporation, a component unit of the Commonwealth of Puerto Rico, provides the workers' compensation to the Office employees.

**(h) Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

**(i) Adoption of New Accounting Pronouncements**

During the fiscal year ended June 30, 2013, the Office adopted the following new accounting standards issued by the GASB:

- (i) GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, establishes recognition, measurement and disclosure requirements for service concession arrangements for both transferors and governmental operators. Governments are now required to account for and report service concession arrangements in the same manner, which improves the comparability of financial statements. The implementation of GASB Statement No. 60 did not have an impact on the basic financial statements.
- (ii) GASB Statement No. 61, *The Financial Reporting Entity: Omnibus-an amendment of GASB Statements No. 14 and No. 34*. This Statement improves financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. The most significant effects of the amendments are to: 1) increase the emphasis on financial relationships by raising the bar for inclusion; 2) refocus and clarify the requirements to blend certain component units, and 3) improve the recognition of ownership interests (joint ventures, component units, investments). The implementation of GASB Statement No. 61 did not have an impact on the basic financial statements.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

- (iii) GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the FASB and AICPA pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements. This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. The implementation of GASB Statement No. 62 did not require modification to the basic financial statements.
- (iv) GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The Statement provides financial reporting guidance for deferred outflows of resources, which is a consumption of net assets by the government that is applicable to a future reporting period and deferred inflows of resources which is an acquisition of net assets by the government that is applicable to a future reporting period. GASB Statement No. 63 also amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets.

**(j) Future Adoption of Accounting Pronouncements**

The GASB has issued the following accounting standards that have effective dates after June 30, 2013:

- (i) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or vice versa. This Statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term deferred in financial statement presentations. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.
- (ii) GASB Statement No. 66, *Technical Corrections 2012*. The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement also amends Statement 62 by modifying the specific guidance on accounting for (1) operating lease

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

payments that vary from a straight line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes clarify how to apply Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

- (iii) GASB Statement No. 67, *Financial Reporting for Pension Plans* — an amendment of GASB Statement No. 25. The objective of this Statement is to improve financial reporting by state and local governmental pension plans. This Statement replaces the requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans* and *Note Disclosures for Defined Contribution Plans*, and No. 50, *Pension Disclosures*, as they relate to pension plans that are administered through trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013.
- (iv) GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* — an amendment of GASB Statement No. 27. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*, as well as the requirements of Statement No. 50, *Pension Disclosures*, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements (hereafter jointly referred to as trusts) that meet certain criteria. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.
- (v) 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. This Statement also provides accounting and financial reporting guidance for disposals of government operations that have been transferred or sold. 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.
- (vi) GASB Statement No. 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees*. The objective of this Statement is to improve accounting and financial reporting by state and local government that extend and receive nonexchange financial guarantees. This Statement requires a governmental entity guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

statements when it is more likely than not that the guarantor will be required to make a payment to the obligation holders under the agreement. This Statement is effective for financial statements for periods beginning after June 15, 2013.

**(4) Deposits**

The Office follows the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No. 3*. Accordingly, the following is essential information about the deposits of the Office at June 30, 2013:

Custodial credit risk is the risk that in the event of a bank failure, the Office's deposits may not be recovered. The Office's cash in governmental banks and the cash under the custody of the Secretary of Treasury are deposited in the Government Development Bank for Puerto Rico, a component unit of the Commonwealth of Puerto Rico. These deposits are uninsured and uncollateralized.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(5) Capital Assets**

Capital assets activity for the year ended June 30, 2013 was as follows:

	<b>Beginning balance</b>	<b>Increases</b>	<b>Decreases</b>	<b>Ending balance</b>
	<b>(as restated)</b>			
Capital assets, non-depreciable:				
Computer software being developed	\$ 427,168	469,044	(314,310)	581,902
Capital assets depreciable:				
Equipment	1,156,010	121,881	(282,174)	995,717
Electronic equipment	3,227,379	167,087	(718,023)	2,676,443
Furniture	1,172,830	759	(66,949)	1,106,640
Computer software	672,084	285,121	(25,900)	931,305
Vehicles	362,100	—	(23,890)	338,210
Total capital asset, depreciable	6,590,403	574,848	(1,116,936)	6,048,315
Less accumulated depreciation and amortization for:				
Equipment	900,954	105,770	(278,560)	728,164
Electronic equipment	2,282,988	398,245	(710,976)	1,970,257
Furniture	914,081	60,206	(66,068)	908,219
Computer software	652,060	11,893	(25,900)	638,053
Vehicles	294,378	21,923	(23,890)	292,411
Total accumulated depreciation and amortization	5,044,461	598,037	(1,105,394)	4,537,104
Total capital asset depreciable	1,545,942	(23,189)	(11,542)	1,511,211
Capital assets, net	\$ 1,973,110	445,855	(325,852)	2,093,113



**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(6) Long-Term liabilities**

Long-term liability activity for the year ended June 30, 2013 was as follows:

	<u>Beginning balance June 30, 2012 (as restated)</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance June 30, 2013</u>	<u>Due within one year</u>	<u>Long-term portion</u>
Accrued compensated absences	\$ 10,704,063	4,460,700	(4,761,241)	10,403,522	2,886,675	7,516,847
Accrued Christmas bonus	701,892	686,180	(701,892)	686,180	686,180	—
	<u>\$ 11,405,955</u>	<u>5,146,880</u>	<u>(5,463,133)</u>	<u>11,089,702</u>	<u>3,572,855</u>	<u>7,516,847</u>

**(7) Lease Commitments**

The Office rents its facilities through operating lease agreements in which the latest expires in 2016. Rent expense under such lease agreements for the year ended June 30, 2013 amounted to approximately \$2,300,000. Future minimum lease payments as of June 30 are as follows:

2014	\$ 2,160,767
2015	1,988,832
2016	<u>26,541</u>
Total	<u>\$ 4,176,140</u>

**(8) Contingencies**

The Office is defendant in a lawsuit pending in court. Management of the Office believes that the ultimate disposition of this matter will not have a material adverse effect on the Office's financial position or results of operations. The Department of Justice of the Commonwealth may represent the Office in any litigation. As established by law, any unfavorable outcome against the Office will be settled ultimately with appropriations of the Commonwealth of Puerto Rico other than the annual appropriations received by the Office.

**(9) Retirement System**

The Office participates in the Employee's Retirement System of the Government of Puerto Rico and its instrumentalities (ERS), a cost sharing multiple-employer retirement plan, which covers only eligible full-time employees. The ERS was created by Act No. 447 of May 15, 1951 and provides retirement, death, and disability benefits and annuities to Commonwealth employees not covered by their own systems.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

Commonwealth legislation requires employees to contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the excess over \$550 of monthly gross salary. The Office is required by the same statute to contribute 10.275% of the participants' gross salary. Total employer contributions during 2013 amounted to approximately \$2,800,000, of which approximately \$500,000 were paid by the Office of Management and Budget of the Commonwealth on behalf of the Office as a result of the Joint Resolution No. 54, dated June 10, 2011.

Effective, July 1, 2011, the Commonwealth implemented increases in the Retirement System approved for all governmental employees. These increases consist of the following:

- An increase in the employer contribution from 9.275% to 10.275%, effective in July 1, 2011
- An increase in the annual employer contribution of 1% of the regular retribution received by the participants, beginning on July 1, 2012 and ending on June 30, 2016, and an annual increase of the employer contribution of 1.25% of the regular retribution received by the participant beginning on July 1, 2016 and ending in June 30, 2021

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, had the option to stay in the ERS or transfer to the new program. Employees hired on or after January 1, 2000 are only allowed to become members of the System 2000.

System 2000 reduced the retirement age from 65 to 60 for those employees who joined the ERS on or after April 1, 1990. System 2000 is a hybrid defined-contribution plan, also known as a cash balance plan. Under this plan, there is a pool of pension assets, which is invested by the ERS together with those of the current defined-benefit plan. The Commonwealth of Puerto Rico will not guarantee benefits at retirement age. The annuity is based on a formula which assumes that each year the employee's contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10%) will be invested in an account which either; (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (2) earn a rate equal to 75% of the return of the System investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined-contribution plans showing their accrued balances. Disability pensions are not granted under System 2000. The employer's contribution (10.275% of the employee's salary) is used to fund the current plan.

For the year ended June 30, 2013, total covered payroll was \$24,942,504. Covered payroll refers to all compensation paid by the Office to employees covered by the ERS on which contributions to the pension are based.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

The amount of the annuity shall be one and one-half percent (1.50%) of the average compensation multiplied by the number of years of creditable service up to 20 years, plus two percent (2.00%) of the average compensation multiplied by the number of years of creditable service in excess of 20 years, for those employees covered after March 31, 1990, the annuity shall be equal to one and one-half (1.50%) percent of the average compensation multiplied by the number of years of creditable service, in no case shall the annuity be less than \$2,400.

Furthermore, on April 4, 2013, the Governor of Puerto Rico signed into law Act No. 3 of 2013, which represents a comprehensive reform of the ERS. Act No. 3 became effective on July 1, 2013 and amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for System 2000 participants, and will be paid at retirement through a lifetime annuity.
- Increases the minimum pension for current retirees from \$400 to \$500 per month.
- The retirement age for Act No. 447 participants will be gradually increased from age 58 to age 61.
- The retirement age for current System 2000 participants is increased gradually from age 60 to age 65.
- Eliminates the “merit annuity” available to participants who joined the ERS prior to April 1, 1990.
- The retirement age for new employees is increased to age 67.
- The employee contribution rate will increase from 8.275% to 10%.
- For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.
- Eliminates or reduces various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees is reduced from \$600 to \$200 and is eliminated for future retirees. The summer bonus will be eliminated.
- Disability benefits will be eliminated and substituted for a mandatory disability insurance policy.
- Survivor benefits will be modified.

Additional information of the ERS is provided in its financial statements for the year ended June 30, 2013 a copy of which can be obtained from the Administrator of the Retirement Systems of the Commonwealth of Puerto Rico, P.O. Box 42003, San Juan, Puerto Rico 00949.

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Financial Statements

June 30, 2013

**(10) General Fund – Fund balance**

At June 30, 2013, portions of the General Fund balances were committed and assigned for specific amounts as follows:

<b>Fund balance</b>	<b>Amount</b>
Committed:	
Repair of vehicles due to collision	\$ 7,257
Assigned:	
Purchased services	588
Professional services	42,190
Other	8,700
Materials and supplies	232
	51,710
Unassigned	3,129,919
	\$ 3,188,886

**REQUIRED SUPPLEMENTARY INFORMATION**

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**

(An Agency of the Commonwealth of Puerto Rico)

Schedule of Revenues, Expenditures, and Changes in Fund Balance –  
Budget to Actual – Non-GAAP Budgetary Basis (General Fund)

Year ended June 30, 2013

	<b>Original budget</b>	<b>Final budget</b>	<b>Actual amounts (Budgetary basis)</b>	<b>Variance- favorable (unfavorable)</b>
Revenue:				
Interest income	\$ —	—	4,993	4,993
Expenditures:				
Salaries and payroll-related expenditures	35,212,000	34,985,000	34,385,672	599,328
Facilities and payments of public services	859,000	873,000	831,893	41,107
Purchased services	3,198,400	3,381,400	3,351,088	30,312
Transportation expenditures	1,629,000	1,629,000	1,611,964	17,036
Professional services	1,382,300	1,410,300	1,229,530	180,770
Other expenditures	202,300	211,300	209,302	1,998
Materials and supplies	456,000	447,000	376,509	70,491
Capital outlays	40,000	42,000	41,089	911
Announcements and media communications required by law	21,000	21,000	6,160	14,840
	<u>43,000,000</u>	<u>43,000,000</u>	<u>42,043,207</u>	<u>956,793</u>
Other financing sources – transfers in:				
Commonwealth appropriations	43,000,000	43,000,000	43,000,000	—
Excess of revenue and other financing sources over expenditures	\$ —	—	961,786	961,786

**COMMONWEALTH OF PUERTO RICO**  
**OFFICE OF THE COMPTROLLER**  
(An Agency of the Commonwealth of Puerto Rico)

Notes to Required Supplementary Information  
Schedule of Revenues, Expenditures, and Changes in Fund Balance –  
Budget to Actual – Non-GAAP Budgetary Basis (General Fund)  
Year ended June 30, 2013

The Office of the Comptroller’s (the Office) budgetary system is its primary control over expenditures. The Office conducts the following procedures in order to establish the budgetary information:

- The Office prepares its annual budget and submits it to the Legislature of the Commonwealth of Puerto Rico for its approval.
- The budget is approved on the basis of a global assignment.
- The Office submits to the Office of Management and Budget of the Commonwealth of Puerto Rico (OMB) the budget detailed by expenditure classification for its recording in the books.
- The budget is prepared using the modified accrual basis of accounting, except for encumbrances, as explained below.

The budgeted revenue presented in the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual – Non-GAAP Budgetary Basis, consisted of a Legislative Appropriation, for the year ended June 30, 2013 for operational appropriations of \$43,000,000.

The primary difference between the budgetary basis and the modified accrual basis under U.S. generally accepted accounting principles (GAAP basis) is the encumbrances that are presented as expenditures under the budgetary basis.

The reconciliation of the expenditures between the budgetary basis and the GAAP basis is as follows:

Change in Fund Balance according to the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual Non–GAAP Budgetary Basis – General Fund	\$ 961,786
Plus prior year encumbrances and expenditures related to unencumbered savings funds recorded as expenditures during current year under the GAAP basis	(769,416)
Less current year encumbrances not recorded as expenditures under the modified accrual basis	<u>51,710</u>
Change in Fund Balance according to the Statement of Revenues, Expenditures, and Changes in Fund Balance – General Fund	<u><u>\$ 244,080</u></u>

It is the Office’s policy that all of the unencumbered funds will remain in the accounting books at the end of the fiscal year for which they were granted. These unencumbered funds are allowed to be partially or totally encumbered for nonrecurrent expenditures.