



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

Financial Statements and Required Supplementary Information

June 30, 2014

(With Independent Auditors' Report Thereon)

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

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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, 2014, 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, 2014, and the respective changes in financial position for the year then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matter

As discussed in note 1, the financial statements of the Office 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, 2014, 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

U.S. generally accepted accounting principles require that the management’s discussion and analysis on pages 3 through 7 and budgetary comparison information on pages 22 through 23 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 October 20, 2014 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
October 20, 2014

Stamp No. E142509 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

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OFFICE OF THE COMPTROLLER
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Management's Discussion and Analysis (Unaudited)
June 30, 2014

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, 2014.

Financial Highlights

- Total liabilities of the Office's governmental activities at the close of the fiscal year ended June 30, 2014 amounted to approximately \$12,300,000 comprising primarily the accrual for vacations and sick leave in the total amount of approximately \$10,600,000. The liabilities exceeded its assets by approximately \$4,100,000 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 \$1,300,000.
- The final budget of the Office for fiscal year 2013-2014 was \$43,000,000.

The Office's revenues and other financing sources exceeded its budgetary basis expenditures by approximately \$1,800,000 for the fiscal year 2013-2014.

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 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, and Act No. 9 of July 24, 1952, as amended.

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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 financial statements can be found on pages 10 to 21 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.

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Net Position

The statement of net position serves as an indicator of the Office's financial position at the end of the fiscal year. The Office's net position increased by approximately \$1,700,000 over the course of fiscal year 2014. The Office's net position includes investment in capital assets for approximately \$2,400,000 and a deficit of approximately \$6,500,000. The following is condensed summary information for fiscal years ended June 30, 2014 and 2013:

	Condensed summary information of net position		
	2014	2013	Change
Current assets	\$ 5,813,160	4,818,059	995,101
Capital assets, net	2,386,190	2,093,113	293,077
Total assets	<u>\$ 8,199,350</u>	<u>6,911,172</u>	<u>1,288,178</u>
Current liabilities	\$ 1,329,394	1,629,173	(299,779)
Noncurrent liabilities	10,957,955	11,089,702	(131,747)
Total liabilities	<u>\$ 12,287,349</u>	<u>12,718,875</u>	<u>(431,526)</u>
Net position:			
Net investment in capital assets	\$ 2,386,190	2,093,113	293,077
Unrestricted – deficit	(6,474,189)	(7,900,816)	1,426,627
Total net position	<u>\$ (4,087,999)</u>	<u>(5,807,703)</u>	<u>1,719,704</u>

Total assets of the Office's at June 30, 2014 increased by approximately \$1,300,000 when compared to the total assets as of June 30, 2013 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, 2014 decreased by approximately \$432,000 when compared to total liabilities at June 30, 2013. This decrease is mainly because of a reduction in employees who elected to go into retirement effective June 30, 2014 when compared with 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, 2014 amounts to approximately \$2,400,000. The Office's capital assets, net increased during 2014 by approximately \$293,000.

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

- The acquisition of software, including capitalization of internally developed software, in the amount of approximately \$550,000,
- Current year's depreciation and amortization of approximately \$500,000,
- The acquisition of equipment, vehicle, and furniture at a cost of approximately \$280,000, and

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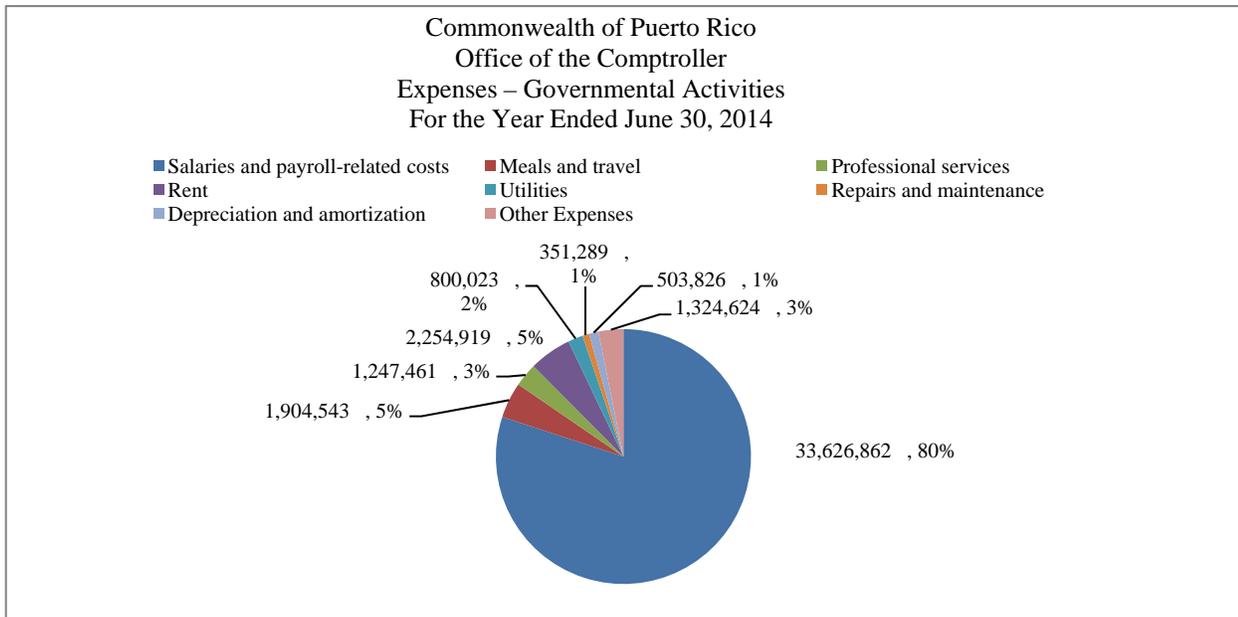
- The retirement of equipment, electronic equipment, furniture, and software in the net amount of approximately \$33,000.

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, 2014:

	<u>2014</u>	<u>2013</u>	<u>Change</u>
Revenues	\$ 6,551	4,993	1,558
Transfers	43,726,700	43,499,700	227,000
Expenses	<u>(42,013,547)</u>	<u>(42,824,357)</u>	810,810
Change in net position	<u>\$ 1,719,704</u>	<u>680,336</u>	<u>1,039,368</u>

The following chart presents the expenses incurred by the Office during the fiscal year ended June 30, 2014:



The Office's major expense is related to salaries, benefits, and payroll taxes, which represent 80% of total expenses incurred during fiscal year ended June 30, 2014. The increase in transfers of approximately \$227,000 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.

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General Fund Budgetary Highlights

The 2013-2014 General Fund Budget was \$43,000,000 and actual expenses in the budgetary basis were \$41,246,190. Total expenditures represented 95.9% of total budget availability for the fiscal year. The Office's expenditure rate decreased by approximately 2% when compared to prior year performance (97.8%).

The following table summarizes the operational results under the non-GAAP budgetary basis of accounting for the fiscal year ended June 30, 2014:

	<u>Actual</u>
Revenue and other financing sources	\$ 43,006,551
Expenditures	<u>41,246,190</u>
Unexpended balance	<u>\$ 1,760,361</u>
Expenditure rate	95.9%

The operational results present a saving on the assigned budget amounting to approximately \$1,800,000 for year ended 2014.

Economic Factors and Next Year's Budget

The Commonwealth has been facing a number of fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, high levels of debt and pension obligations, and a downgrading by the major rating agencies of the general obligation bonds of the Commonwealth to noninvestment grade rating. These factors could have had an adverse effect in the Commonwealth ability to achieve a balanced budget and improved its financial condition.

On June 17, 2014, the Governor signed into law Act No. 66, (also known as Fiscal Operation and Sustainability Act), which provides the legal base to address certain cost escalators to achieve a balanced budget. The Commonwealth, in order to reduce its deficit, made a reduction on its general fund budget for 2015 fiscal year in the amount of \$205,000,000. As a result of this reduction, the Office approved budget for the fiscal year 2015 is \$40,315,000, a reduction of \$2,685,000 when compared to 2014 fiscal year.

The Office adopted cost reduction measures that resulted in a decrease in certain employee benefits accrued in the government-wide financial statements.

Requests for Information

This financial report is designed to provide a general overview of the Office'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.

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General Fund Balance Sheet and Statement of Net Position

June 30, 2014

	General Fund Balance Sheet	Adjustments	Statement of Net Position
Assets:			
Cash in governmental bank	\$ 5,746,264	—	5,746,264
Cash under the custody of the Secretary of Treasury of the Commonwealth of Puerto Rico	7,257	—	7,257
Accounts receivable – employees and other	59,639	—	59,639
Capital assets:			
Nondepreciable	—	227,641	227,641
Depreciable, net	—	2,158,549	2,158,549
Total assets	5,813,160	2,386,190	8,199,350
Liabilities:			
Accounts payable and accrued liabilities	1,329,394	—	1,329,394
Other accrued long-term liabilities, due within one year	—	5,358,883	5,358,883
Other accrued long-term liabilities, due after one year	—	5,599,072	5,599,072
Total liabilities	1,329,394	10,957,955	12,287,349
Fund balance/net position:			
Fund balance:			
Committed	7,257	(7,257)	—
Assigned	53,883	(53,883)	—
Unassigned	4,422,626	(4,422,626)	—
Total fund balance	4,483,766	(4,483,766)	—
Total liabilities and fund balance	\$ 5,813,160		
Net position:			
Net investment in capital assets		2,386,190	2,386,190
Unrestricted		(6,474,189)	(6,474,189)
Total net position		\$ (4,087,999)	(4,087,999)

See accompanying notes to financial statements.

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

June 30, 2014

	General Fund Revenues, Expenditures, and Changes in Fund Balance	Adjustments	Statement of Activities
Expenditures/expenses:			
General government:			
Salaries and payroll-related costs	\$ 33,758,609	(131,747)	33,626,862
Meals and travel	1,904,543	—	1,904,543
Professional services	1,247,461	—	1,247,461
Insurance	38,413	—	38,413
Rent	2,254,919	—	2,254,919
Utilities	800,023	—	800,023
Noncapitalizable equipment	37,214	—	37,214
Materials and supplies	101,166	—	101,166
Repairs and maintenance	351,289	—	351,289
Depreciation and amortization	—	503,826	503,826
Loss on disposition of assets	—	33,230	33,230
Trainings and continuing professional education	241,404	—	241,404
Subscriptions and memberships	116,964	—	116,964
Outsource services:			
Security	235,492	—	235,492
Maintenance	118,378	—	118,378
Other	368,570	—	368,570
Printing services	20,457	—	20,457
Postage	4,297	—	4,297
Miscellaneous	9,039	—	9,039
Capital outlays	830,133	(830,133)	—
Total expenditures/expenses	<u>42,438,371</u>	<u>(424,824)</u>	<u>42,013,547</u>
General revenue – Interest income	6,551	—	6,551
Other financing sources – Transfers:			
Commonwealth of Puerto Rico appropriations	43,000,000	—	43,000,000
Other Commonwealth of Puerto Rico appropriations under Joint Resolution No. 17, of June 30, 2013	726,700	—	726,700
Total general revenue and transfers	<u>43,733,251</u>	<u>—</u>	<u>43,733,251</u>
Excess of revenue and transfers over expenditures	1,294,880	(1,294,880)	—
Change in net position	—	1,719,704	1,719,704
Fund balance/net position:			
At beginning of year	<u>3,188,886</u>	<u>(8,996,589)</u>	<u>(5,807,703)</u>
At end of year	<u>\$ 4,483,766</u>	<u>(8,571,765)</u>	<u>(4,087,999)</u>

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2014

(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/her 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 requested 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 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 noncommitted cash of the Office that was previously under the custody of the Secretary of Treasury of the Commonwealth 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 an agency of the Commonwealth. 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.

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Notes to Financial Statements

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(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 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, 2014:

Fund balance	\$	4,483,766
Add capital assets, net of accumulated depreciation, as they are not financial resources and, therefore, are not reported in the General Fund		2,386,190
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>(10,957,955)</u>
Net position	\$	<u><u>(4,087,999)</u></u>

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June 30, 2014

The following is a reconciliation between the excess of revenue and transfers 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, 2014:

Excess of revenue and transfers over expenditures	\$ 1,294,880
Less current year change in compensated absences that are recorded as a long-term liability in the government-wide financial statements	(160,765)
Add current year change in accrued Christmas bonus that is recorded as a long-term liability in the government-wide financial statements	292,512
Less current year depreciation and amortization, as the cost of assets is allocated over their useful lives in the statement of activities	(503,826)
Less loss on disposal of assets that were not capitalized in the General Fund	(33,230)
Add capital outlays reported as expenditures in the General Fund that are shown as capital asset additions in the government-wide financial statements	<u>830,133</u>
Change in net position	<u>\$ 1,719,704</u>

(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.

(2) 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.) Under Act No. 58, the Office is permitted to maintain and manage its cash accounts separate from the Cash Pool.

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(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:

	Years
Electronic equipment	5
Other equipment	5
Furniture	10
Purchased computer software	5
Internally developed software	3–10
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, until December 31, 2014. As of January 1, 2015, the sick leave may not be accumulated in excess of the maximum permitted of ninety (90) days. Any employee with a sick balance in excess of the maximum of ninety (90) days will lose that excess beginning January 1, 2015. 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.

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Notes to Financial Statements

June 30, 2014

(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, 2014.
- 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, 2014.
- 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, 2014.
- (iii) Unrestricted – This consists of net position that does not meet the definition of "restricted" or "net investment in capital assets."

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(f) Commonwealth Appropriations

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

(g) Risk Financing

The Commonwealth 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 worker's compensation the State Insurance Fund Corporation, a component unit of the Commonwealth, provides the worker's 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, 2014, the Office adopted the following new accounting standards issued by the GASB:

- (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 implementation of GASB Statement No. 65 had no impact in the accompanying financial statements.
- (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 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)

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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 implementation of GASB Statement No. 66 had no impact in the accompanying financial statements.

- (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 implementation of GASB Statement No. 67 had no impact in the accompanying financial statements.
- (iv) 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 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. The implementation of GASB Statement No. 70 had no impact in the accompanying financial statements.

(j) Future Adoption of Accounting Pronouncements

The GASB has issued the following accounting standards that have effective dates after June 30, 2014:

- (i) 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.
- (ii) 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

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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.

- (iii) GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined-benefit pension plan after the measurement date of the government's beginning net pension liability. This Statement amends 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. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014.

(3) Deposits

The Office follows the provisions of GASB Statement 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, 2014:

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. These deposits are uninsured and uncollateralized.

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(4) Capital Assets

Capital assets activity for the year ended June 30, 2014 was as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
Capital assets, nondepreciable:				
Computer software being developed	\$ 581,902	468,173	(822,434)	227,641
Capital assets depreciable:				
Equipment	995,717	16,508	(13,798)	998,427
Electronic equipment	2,676,443	226,381	(61,939)	2,840,885
Furniture	1,106,640	7,944	(6,562)	1,108,022
Computer software	931,305	878,218	(4,148)	1,805,375
Vehicles	338,210	27,977	—	366,187
Total capital asset, depreciable	<u>6,048,315</u>	<u>1,157,028</u>	<u>(86,447)</u>	<u>7,118,896</u>
Less accumulated depreciation and amortization for:				
Equipment	728,164	67,250	(13,453)	781,961
Electronic equipment	1,970,257	284,333	(59,719)	2,194,871
Furniture	908,219	54,991	(6,562)	956,648
Computer software	638,053	77,610	(849)	714,814
Vehicles	292,411	19,642	—	312,053
Total accumulated depreciation and amortization	<u>4,537,104</u>	<u>503,826</u>	<u>(80,583)</u>	<u>4,960,347</u>
Total capital asset depreciable	<u>1,511,211</u>	<u>653,202</u>	<u>(5,864)</u>	<u>2,158,549</u>
Capital assets, net	<u>\$ 2,093,113</u>	<u>1,121,375</u>	<u>(828,298)</u>	<u>2,386,190</u>

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(5) Long-Term liabilities

Long-term liabilities activity for the year ended June 30, 2014 was as follows:

	<u>Beginning balance June 30, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance June 30, 2014</u>	<u>Due within one year</u>	<u>Long-term portion</u>
Accrued compensated absences	\$ 10,403,522	4,927,730	(4,766,965)	10,564,287	4,965,215	5,599,072
Accrued Christmas bonus	686,180	393,668	(686,180)	393,668	393,668	—
	<u>\$ 11,089,702</u>	<u>5,321,398</u>	<u>(5,453,145)</u>	<u>10,957,955</u>	<u>5,358,883</u>	<u>5,599,072</u>

(6) 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, 2014 amounted to approximately \$2,200,000.

(7) 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 other than the annual appropriations received by the Office.

(8) 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 legislation requires employees to contribute 7% for the first \$550 of their monthly gross salary and 10% for the excess over \$550 of monthly gross salary. The Office is required by the same statute to contribute 12.275% of the participants' gross salary. Total employer contributions during 2014, 2013, and 2012 amounted to approximately \$3,000,000, \$2,800,000, and \$2,600,000, respectively, of which approximately \$727,000, \$500,000, and \$249,000, respectively, 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. 17, dated June 30, 2013. Total contributions represent 100% of the annual required contribution determined on a pay-as-you-go basis.

Pursuant to Act No. 116 of July 6, 2011, the Office is subject to annual increases in the employer contribution of 1% of the regular retribution received by the participants until the year ending on June 30,

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2016, and 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 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 80% 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 (12.275% of the employee's salary) is used to fund the current plan.

For the year ended June 30, 2014, total covered payroll was approximately \$24,000,000. Covered payroll refers to all compensation paid by the Office to employees covered by the ERS on which contributions to the pension are based.

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%.

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- 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.

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- 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, 2014 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.

(9) General Fund – Fund balance

At June 30, 2014, portions of the General Fund balances were committed and assigned for specific amounts as follows:

Fund balance	Amount
Committed:	
Repair of vehicles due to collision	\$ 7,257
Assigned:	
Purchased services	1,535
Professional services	52,348
	53,883
Unassigned	4,422,626
	\$ 4,483,766

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

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

June 30, 2014

	<u>Original budget</u>	<u>Final budget</u>	<u>Actual amounts (Budgetary basis)</u>	<u>Variance- favorable (unfavorable)</u>
Revenue:				
Interest income	\$ —	—	6,551	6,551
Expenditures:				
Salaries and payroll-related expenditures	35,212,000	34,511,500	33,109,524	1,401,976
Facilities and payments of public services	859,000	859,000	800,023	58,977
Purchased services	3,198,000	3,415,000	3,310,013	104,987
Transportation expenditures	1,629,000	1,746,000	1,745,945	55
Professional services	1,383,000	1,720,500	1,576,891	143,609
Other expenditures	202,000	214,000	206,109	7,891
Materials and supplies	456,000	456,000	438,532	17,468
Capital outlays	40,000	57,000	55,526	1,474
Announcements and media communications required by law	21,000	21,000	3,627	17,373
	<u>43,000,000</u>	<u>43,000,000</u>	<u>41,246,190</u>	<u>1,753,810</u>
Other financing sources – transfers:				
Commonwealth appropriations	<u>43,000,000</u>	<u>43,000,000</u>	<u>43,000,000</u>	<u>—</u>
Excess of revenue and other financing sources over expenditures	\$ —	—	1,760,361	1,760,361

See accompanying notes to required supplementary information.

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

June 30, 2014

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 Schedule 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, 2014 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 Schedule of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual Non-GAAP Budgetary Basis – General Fund	\$ 1,760,361
Plus current year encumbrances not recorded as expenditures under the modified-accrual basis	53,883
Less expenditures recorded against unencumbered appropriations carried forward from prior year	(514,000)
Less prior year encumbrances recorded as expenditures under the modified-accrual basis	<u>(5,364)</u>
Change in Fund Balance according to the Schedule of Revenues, Expenditures, and Changes in Fund Balance – General Fund	<u><u>\$ 1,294,880</u></u>

It is the Office’s policy that all unencumbered funds at the end of the fiscal year be carried forward to future periods as permitted by Act. No. 230 of July 23, 1974. These unencumbered funds are allowed to be partially or totally encumbered for nonrecurrent expenditures.