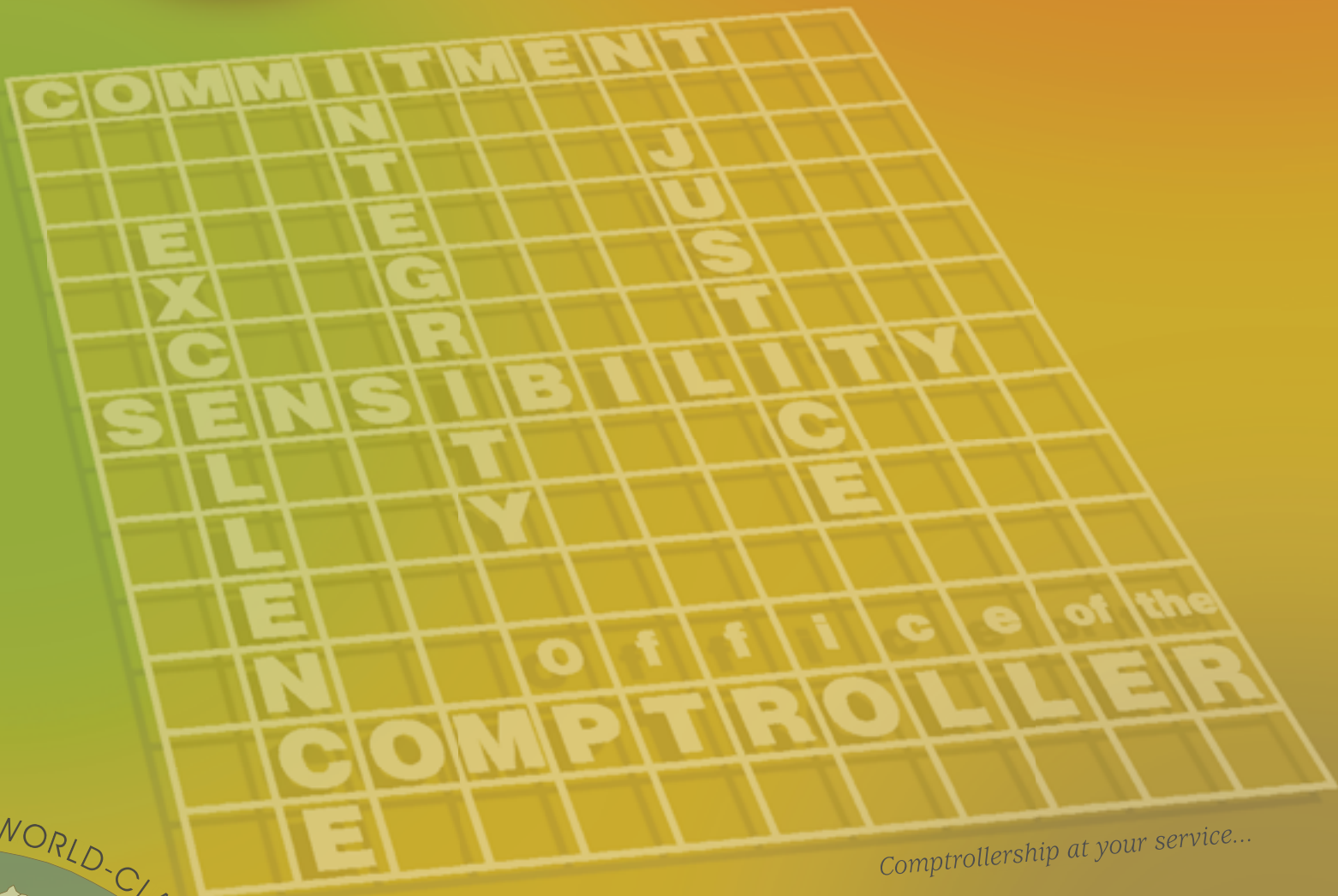


COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For Fiscal Year Ended June 30, 2004



Comptrollership at your service...



TQM
Total Quality Management Organization



OFFICIAL SHIELD

The sky-blue color represents loyalty and truth, essential values in public service.

The crossed keys with the gold coins mean fidelity, security safe-keeping of the people's moneys and properties.

The satellite orbiting above the earth represents the era of information technology systems and telecommunications.

The planet symbolizes a new world, of which we are all a part thereof.

Bordering the shield, we have the five values that are part of our public service philosophy.

OUR VALUES

We are dedicated to our work.

We work in a responsible manner.

We respect the dignity of all human beings.

We watch for the strictest compliance with the law.

We are constantly improving ourselves.

WE COUNT ON YOUR COOPERATION TO IMPROVE THE OVERSIGHT FUNCTION AND ADMINISTRATION OF PUBLIC FUNDS AND PROPERTY

Additional information related to
the Office of the Comptroller of Puerto Rico
is available through the Internet at:

www.ocpr.gov.pr

In an effort to reduce the cost of printing,
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Office of the Comptroller
105 Ponce de León Ave, Hato Rey, Puerto Rico 00919

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For Fiscal Year Ended June 30, 2004

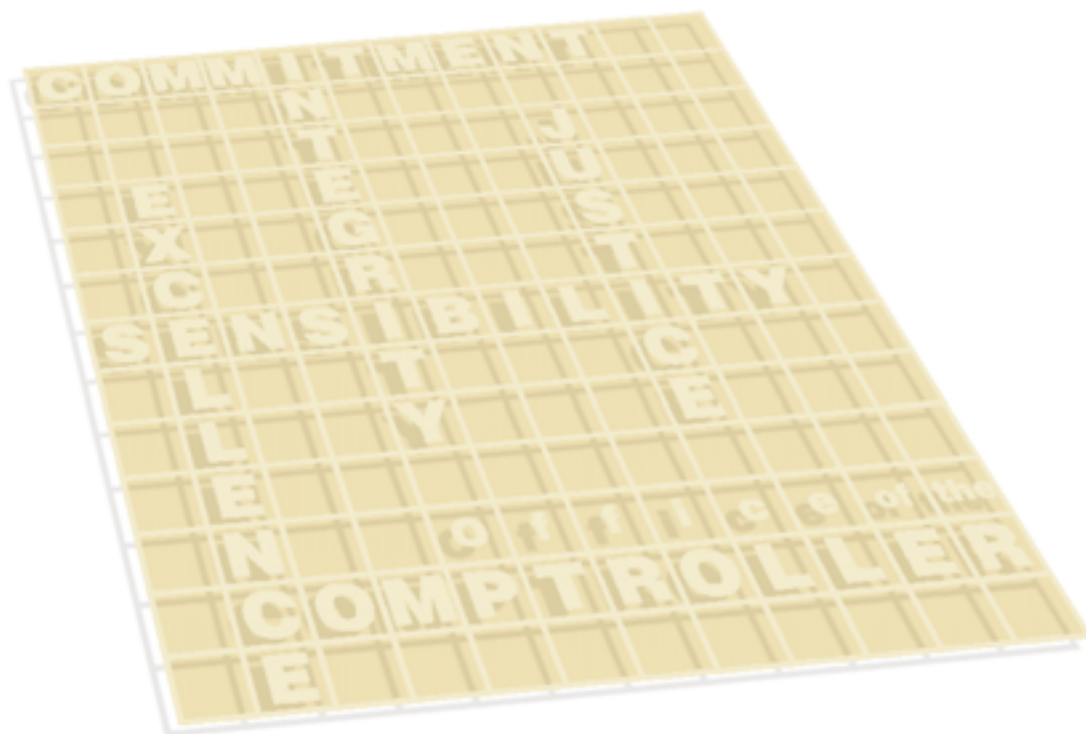


Prepared by the Office of the Comptroller of Puerto Rico

Manuel Díaz Saldaña, CPA, CFE
Comptroller

November 15, 2004

Comptrollership at your service...



COMMONWEALTH OF PUERTO RICO OFFICE OF THE COMPTROLLER

MISSION

To oversee the transactions of public funds and property, with independence and objectivity, in order to ascertain that they have been carried out in accordance with the law. To promote the effective and efficient use of government resources for the benefit of our people.

VISION

To be a world-class model for public office, distinguished by: the excellence of its highly qualified human resources, its dedication to continuous improvement, a sophisticated infrastructure and optimum quality service.

To serve Puerto Rico as a true agent of change, integrating the efforts of the public and private sectors, in order to promote the honest use of the resources entrusted to the government by the people.

VALUES

Commitment

We are dedicated to our work.

Integrity

We work in a responsible manner.

Sensibility

We respect the dignity of all human beings.

Justice

We watch for the strictest compliance with the law.

Excellence

We are constantly improving ourselves.

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COMMONWEALTH OF PUERTO RICO

OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For Fiscal Year Ended June 30, 2004

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Introduction Section

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Letter of Transmittal

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Commonwealth of Puerto Rico
Office of the Comptroller

Manuel Díaz Saldaña
Comptroller

November 15, 2004

To the Governor of Puerto Rico,
the President of the Senate,
the Speaker of the House of Representatives,
the Members of the Legislature,
and the People of Puerto Rico:

It is our pleasure and ministerial duty to submit the Comprehensive Annual Financial Report of the Office of the Comptroller of Puerto Rico, hereinafter referred to as the Office, for the fiscal year ended June 30, 2004. The Office is responsible for the accuracy, completeness, and fairness of the information and disclosures included in this document. All disclosures necessary for a reasonable understanding of the financial activities have been included. To the best of our knowledge, the information presented herein is accurate. The Comprehensive Annual Financial Report includes three sections:

Introduction: This section has not been audited and provides general information about the report. It also includes the Comptroller's transmittal letter, a listing of the principal officers, and the organizational charts.

Financial: The Financial Section comprises the Report of the Independent Auditors, the financial statements of the Office, notes to the financial statements and the Report of Independent Auditors on Compliance and Internal Control Over Financial Reporting in Accordance with Government Auditing Standards.

Statistics: These data have not been audited. They provide information about finances, economics, and operational matters related to the Office that is generally presented on a comparative basis.

General Information about the Commonwealth of Puerto Rico

Geography and Population

Puerto Rico is the fourth largest of the Caribbean islands and is located approximately 1,600 miles Southeast of New York. It is approximately 100 miles long and 35 miles wide. According to the United States Census Bureau, the population of Puerto Rico was approximately 3,900,000 in 2003. The Puerto Rico Planning Board estimates that as of July 2006, the population will be 3,907,122.



Relationship with the United States

Christopher Columbus discovered Puerto Rico in 1493. Shortly thereafter, the Island was settled by the Spaniards and remained as a Spanish possession for four centuries. The Island came under the sovereignty of the United States with the signing of the Treaty of Paris on December 10, 1898, at the conclusion of the Spanish-American War.

Puerto Ricans became citizens of the United States in 1917, by virtue of the Jones Act, approved by the Congress of the United States. In 1950, the Congress of the United States enacted Public Law 600 in order to allow for an increased self-government for the island. This Law set forth the political, economic and fiscal relationship between Puerto Rico and the United States. It also provided for the drafting and adoption of a local constitution on July 25, 1952. Among other things, our constitution created the position of the Comptroller and defined its role in government.

The Constitution of Puerto Rico was drafted by a Constituent Commission, approved in a special referendum by the people of Puerto Rico, amended and ratified by the United States Congress, and subsequently approved by the President of the United States. The official designation of the Government or body politic has henceforth been “Estado Libre Asociado”, which literally translates to “Free Associated State”, and has been called “Commonwealth” by the United States Government.

Puerto Rico exercises virtually the same control over its internal affairs as any of the fifty states of the Union. However, it differs from the federated states in its relationship with the Federal Government. The People of Puerto Rico are citizens of the United States, can only vote in local (Puerto Rico) elections, and are represented in Congress by a Resident Commissioner who has a voice in the House of Representatives and limited voting power.

General Information of the Office of the Comptroller

The Comptroller of Puerto Rico has the constitutional duty to oversee all revenues, accounts and disbursements of the Commonwealth of Puerto Rico and to ascertain that all operations involving public funds and public property are performed according to applicable laws and regulations. This authority arises from Section 22, Article III of the Constitution of the Commonwealth of Puerto Rico, and from the Public Law that creates the Office of the Comptroller of Puerto Rico, Law No. 9 of July 24, 1952, as amended.

On October 2, 1997, the Governor appointed CPA Manuel Díaz Saldaña as Comptroller, with the advice and consent of the Legislature, as prescribed by the Constitution. This appointment is for a term of 10 years.

Government agencies are audited through the application of various Government Auditing Standards and other pertinent investigative techniques adopted by the Comptroller. Results, including findings and recommendations, are presented in the audit reports, thus providing for appropriate corrective actions. Violations of law are referred to the appropriate administrative, civil or criminal enforcement agencies.

The Office has divided all the government entities of the Executive, Legislative and Judicial branches into 2,258 units for auditing or examination purposes. This figure includes departments, agencies, public corporations, municipalities, and 1,562 community schools.

The findings of the audit reports fall under two main categories:

Primary: Serious violations of law and applicable regulations are considered primary violations. These include: errors, irregularities of material importance related to falsification, embezzlement, misapplication of accounting standards and relevant legal dispositions, mathematical errors or misinterpretation of facts.

Secondary: Inconsequential omissions or errors.

The chief executive of the audited agency is required to inform the Office of the actions taken or that will be taken in order to comply with the recommendations resulting from the audit.

Official Seal and Shield

A new seal and shield were adopted during fiscal year 1997-98. The silver field represents the integrity, firmness and vigilance of the Office of the Comptroller of Puerto Rico in our mission to oversee the transactions of public funds and property, with independence and objectivity, to ascertain that they have been carried out in accordance with the law. The terrestrial globe means that we are part of a world in constant evolution and improvement. This is an essential component of our organizational vision, to be a world-class model for public office. The satellite represents the era of information technology systems and telecommunications, essential instruments for a leading role position in auditing techniques, and much needed to achieve a sophisticated infrastructure for optimum quality services. The sky-blue color within the left partition represents justice, loyalty and truth, special qualities present in our daily work. The two keys on top mean fidelity, security and discretion in the custody of the public funds represented by the golden bezants.

Strategic Plan

The Office operates according to a Strategic Plan for the years 2001-2004 and an Annual Operations Plan. The Strategic Plan is divided into eight Focal Areas, with several strategies and activities that are being developed in order to make the projected goals a reality.

Each year we establish the objectives that we propose to accomplish depending on the resources that are assigned to our Office.

We published the third Strategic Plan for 2004-2007 including five focal areas, strategic objectives, initiatives, and measures of success.

We have attained significant goals using the managerial philosophy of Total Quality Management to optimize the use of funds that have been assigned to conduct our operations. The commitment and dedication of our excellent working team has permitted us to attain the goals we summarize henceforth:

Oversight

1. Published 200 audit reports during the fiscal year. When compared with the previous fiscal year, this amount represents an increase of approximately eight per cent.

Among the most important reports published are:

- a. Audit report DB-04-07 of October 23, 2003, concerning the Results of the Fourth Evaluation of Functional Performance of the Sectors Composing the Property Registry of Puerto Rico.
- b. Audit Report CP-04-14 of February 10, 2004, regarding the Second Evaluation of the University of Puerto Rico Campuses on Complying with Certain Criteria Established by this Office for Improving Public Administration.
- c. Audit Report M-04-04F of April 16, 2004, regarding the Sixth Evaluation of the Municipalities on Complying with Certain Criteria Established by this Office for Improving Public Administration.
- d. Audit Report CP-04-25 of May 10, 2004, regarding the Water & Wastewater Plants of the Puerto Rico Aqueducts and Sewer Authority.
- e. Twenty-four audit reports regarding the Community Schools.



2. For the first time, the Comptroller of Puerto Rico presented an oral testimony and a written report to the United States House of Representatives, Committee on Energy and Commerce, Subcommittee on Oversight and Investigations, related to the Audit Report TI-03-09 E-Rate Funds of the Puerto Rico Department of Education.
3. In November 2003, the Comptroller of Puerto Rico participated in a meeting with the Domestic Working Group of the General Accounting Office (GAO) to promote the effective interaction of government employees in key issues related to audits in the public sector and make recommendations to improve the government services.
4. Initiated 11 pilot audits using the TeamMate System, an electronic program designed to reduce the use of paper in the audit function. In addition, we trained assistant and senior auditors, as well as audit managers on the proper use of the TeamMate System.
5. Established the **Quality Compliance Auditing Guidelines** as well as the **Quality Inspection Evaluation Criteria for Audit Managers**.
6. Approved and distributed to internal auditors from municipalities, agencies, departments, and public corporations a Manual for Internal Audit Activity at the Office of the Comptroller of Puerto Rico.
7. Designed an Internet site to deal with audit issues.

Education and Orientation

1. Offered lectures to 71 elected officials on the proper use of public property and funds in compliance with Law No. 222 of August 6, 1999, as amended.
2. Offered lectures to government officials and employees, and members of non-profit organizations, as part of our on-going campaign on **Zero Tolerance for Corruption (“Cero Tolerancia a la Corrupción”)**.
3. Offered orientations concerning sound public administration to 2,318 government officers and employees. Among others, we offered orientations related to:
 - a. Recommended criteria to grant special recognitions to municipal consortiums.
 - b. The auction process to the members of the auction boards of municipalities and consortiums.
 - c. Use of property and public funds by the members of the Municipal Police.
4. Participated in national and international meetings and conferences related to our investigative and preventive functions such as: Enterprise Risk Management and Control, National Internal Audit Forum, Biennial Forum of Government Auditors, TeamMate Forum, American Society Training and Development (ASTD), National Association of State Auditors, Comptrollers and Treasurers (NASACT).
5. Offered the annual training for government and municipalities internal auditors.
6. Developed and facilitated the training of employees in order to comply with hours of continued education required in our Office.

Strategies Developed for Proper Administration

1. Endorsed the approval of Law No. 273 of September 10, 2003, concerning the contractual norms regarding the autonomy of the external audits of government entities. Also, we published the **Circular Letter OC-04-13** of November 3, 2003, concerning the approval and orientation of said Law.

2. Published the Second Edition of Recommendations for Combating Corruption and Encouraging Good Practices of Public Administration (**Plan CTC 2004**).
3. Implemented the Privatization Register on Internet, as required by Law No.136 of June 7, 2003.

Customer Services

1. As part of the results obtained with Total Quality Management, we have significantly advanced in the continued effort to improve processes and in the Office's cultural change, as follows:
 - a. Increased the efficiency of 26 processes.
 - b. Completed two additional rounds of Process Improvement Teams.
 - c. Administered the Workplace Environmental Quality Survey in order to obtain our fellow-workers perception on the application of the Ten Management Practices adopted. Results revealed that on a five-point scale, March, 2004 findings were 4.14 points, which reflects an increase of .59 points or an increase of 17 per cent on the index, compared with the first survey which was taken in June 1998 (3.55).
2. Approved a general procedure (P-G-1) which standardizes the instructions for the application, preparation, codification, control and distribution of all Office regulations.
3. As part of our commitment with saving our environment, the Office participated in the shredding and recycling program and received a Certificate that assured the saving of 96 trees from destruction.

Human Capital

1. Trained all our fellow-workers on Sexual Harassment and other forms of discrimination.
2. Complied with a statutory requirement by training all our fellow-workers regarding Government Ethics.
3. Provided increases in marginal benefits to retain and attract highly qualified personnel. The Bonus for Productivity and the government quota for the Medical Plan were increased. A program known as **Comptrollership in Shape ("Contraloría en Forma")** was promoted to help fellow-workers maintain good physical condition. Lectures were offered to interested fellow-workers and their immediate families, in a program known as **Strengthening the Family ("Fortalecimiento Familiar")**.
4. As part of our commitment to the community, we engaged in special activities. Among them: blood donation campaigns, collecting and donating toys to children of limited economic resources, and used clothing donated to the Salvation Army. This year, the Office was awarded the Bronze Prize because of its contribution to the Charity Campaign of Public Employees.
5. A Policy on Safety and Occupational Health was adopted in response to our concern for the health and safety of Office personnel.
6. Participated in international conference for the Society for Human Resources Management (SHRM).

Technology

1. As part of our Technology Improvement Plan, we completed and implemented 33 programs and projects related to the technology. Some of the most important are:
 - a. Design of new Internet and Intranet home pages.
 - b. Access to daily news through the Intranet (**TituCont**).



- c. Integration of **HelpDESK/HelpSTAR** System for the administration of internal and external technical services requests.
2. Installed the **5.0 version** of the **Winnebago Spectrum Program**. All Office Personnel was registered in order to be able to conduct loans of bibliographical data electronically. Property numbers were added to the publications for future references and control.
3. Updated the **MIP Program** and a new version of the program of Property Inventory to optimize the use of financial information.
4. Implemented the software program **Time Matters 4.0** to improve the operation of the Legal Division.

Communication

1. Notified subscribers that documents and general information had been published on the Internet as a weekly newsletter.
2. Included a Questions & Answers section on the Internet in order to attend, quickly and concisely, doubts and frequent inquiries about our Office.

Infrastructure

The Office, from the day it was created, has never owned a building as an official site that may enable us to provide more efficient services. It operates from six different rented buildings dispersed in the area of Hato Rey. Its central offices are located in Avenida Ponce de León 105 Hato Rey, San Juan, Puerto Rico.

Law No. 38 of January 10, 1999, authorizes the acquisition of office space to acquire, possess, use, and dispose of immovable property for the location of our offices. The Treasury Commission of the Senate of Puerto Rico proposed Joint Resolution 449 of August 16, 2001, ordering the Lands Administration to transfer without profit and free from any liens or other encumbrances a plot of land in Hato Rey in which to construct the required building. We received the Resolution for comments on March 4, 2003. The Office endorsed the same; nevertheless, it never became law. All our endeavors have not yet been successful in obtaining the resources needed.

Total Quality Management Organization

Seminars

Pursuant to our **Route to Excellence** program we offered the following seminars during the year:

1. **Basic Total Quality Seminar** was offered to 49 newly hired personnel. One hundred percent of our work force is fully trained.
2. **Effective Communications Seminar** to continue improving the Quality of Work Environment.
3. **How to Exercise your Memory Seminar** aimed at maintaining the excellence of our human resources, according to our Vision of Excellence.
4. **Six Sigma Seminar** to improve the skills of our Process Improvement Team coordinators.

External Seminars

In order to keep abreast on the best practices in international quality management issues, two staff members participated in the 58th Annual Congress on Quality sponsored by the American Society for Quality (ASQ). Representatives of different companies and organizations presented their work models designed to obtain high returns and competitiveness in order to satisfy the needs of their clients. In this Congress we were able to compare our trajectory with that of international members of the quality community.

Improving Processes

We have continued with the commitment to analyze existing processes in our organization, improve them, and identify the pertaining variables so as to monitor behavior, measure progress, and control the processes. As of June 30, 2004, we had improved 62.61% of our processes, 144 of the 230 processes that have been identified in our organization.

Efficiency

Efficiency in Some of the Processes Reviewed as a Result of Continuous Improvement

Process	Initial Value	Value at June 30, 2004
Revision of Audit Reports (Simple Audits)	146 days	10.8 days
Draft Writing - Audit Reports (Simple Audits)	52 hrs.	12.96 hrs.
Requests of contracts (1-5 contracts)	3.7 days	20.6 minutes
Requests of Contracts (6 or more)	6.7 days	107.6 minutes

As shown in this table, the efficiency of the processes depicted continues to be outstanding. This enhancement is the result of the implementation of continuous process improvement methods and our commitment to this endeavor.

Newsletter - Quality Comptrollership "*Contraloría con Calidad*"

We have published four editions of the Quality Newsletter which informs our personnel of our accomplishment and provides updates on the latest TQM techniques and best practices.

At the request of the *Oficina de Control de Drogas*, we gave a speech to their executives on May 24, 2004. It dealt with the benefits of adopting and implementing the managerial philosophy of Total Quality in the Comptrollers' Office and the results obtained.

The Corrective Action Plan

The Corrective Action Plan (CAP) is a follow-up mechanism that ensures compliance with the recommendations made by the Office in its audit reports. This program was implemented pursuant to the provisions of Law No. 9 *supra*, which allows the Comptroller, in the exercise of his authority, to adopt practices and procedures generally accepted in current auditing practices.

On May 6, 1988, the Governor of Puerto Rico issued Executive Order 5098D. This Order requires that the chief executive of an audited unit implement the corrective actions in compliance with the Comptroller's recommendations. The Executive Order also requires the Office of Government Ethics to follow up on the findings included in the reports in order to identify any violation of Law No. 12 (July 24, 1985), known as the "Law on Government Ethics". In addition, on November 1, 1990, the Office approved Regulation No. 26 implementing the CAP. This regulation requires the Treasury Department, the Office of the Commissioner of Municipal Affairs (formerly the Administration of Municipal Services) and the Boards of Directors of Public Corporations to verify that audited entities have complied with the CAP by implementing the recommended corrective measures within a given time period.

The CAP also provides a mechanism to ensure that cases referred to the Department of Justice are given proper attention. An agreement with the Secretary of Justice requires that twice a year, the Department informs the Comptroller on the status of the referred cases.



On June 13, 1998, the Governor issued Administrative Bulletin Number OE-1998-16, superseding Executive Order 5098D. As a result, the Office issued a new Regulation No. 26, effective July 1, 1998. Accordingly, beginning with fiscal year 1998-99, all government entities have 90 days to submit the CAP. The 90 days allowed begin on the first day of the month following the publication of the audit report. The 90-day time span to submit complementary reports begins on the first day of the month following the CAP or a previous complementary report. All government entities are encouraged to delegate responsibility for the CAP on the internal audit units.

By June 30, 2004, the Comptroller's Office had received 703 and evaluated 602 CAPs to ascertain compliance with the recommendations contained in the audit reports. This figure includes initial CAPs and subsequent progress reports. During fiscal year 2002-03 the Office received and evaluated 735 CAPs.

The Administrative Bulletin *supra* and Regulation No. 26 state that government entities should apply the same procedures applicable to the Comptroller's audit report recommendations contained in the external auditor's management letters. If, upon due consideration, the agency heads determine that the recommendations of the external auditors cannot be adopted, and such determination is appropriately documented and sustained, the Comptroller may excuse them from compliance.

The entire operation of the corrective action program continues to be reviewed, since we are looking for optimum efficiency in the follow-up process, in order to increase compliance with the recommendations and to develop quicker and accurate statistical data.

Public Registry on Contracts of Government Agencies and Municipalities

According to Law No. 18 of October 30, 1975, as amended, by Law No. 17 of November 29, 1990, government agencies, including public corporations and municipalities are required to maintain a registry of all the contracts and deeds, including subsequent amendments thereto. Additionally, they have to submit a copy of contracts, deeds and amendments to the Office within 15 consecutive days from the date of execution or within 30 consecutive days if the contract is executed outside of Puerto Rico. Exceptions to this requirement are set forth in the statute and Regulation No. 33 issued by the Comptroller on February 27, 1998.

The Office maintains a registry and a file for every contract received and uses the Registry for verification purposes as part of its oversight role. The Registry is accessible to the general public via Internet since 1999 at www.ocpr.gov.pr. Interested parties may request copies of these contracts. A nominal fee is required for each copy. The Office received 2,673 requests for copies during fiscal year 2003-04.

The information system related to the Registry of Government Contracts established in 1990-91 has proven to be an efficient research tool related to contracts executed by government entities. This System has a search feature which allows for the retrieval of information using various references, fields, or clues such as: social security number, name of the contractor, or type of contract. Furthermore, the system is capable of furnishing elaborate statistical information regarding the types of contracts most frequently executed by an agency or group of agencies, the number of agencies that are late in submitting contracts, the agencies that submit contracts with erroneous information, and those that belatedly submit corrected information after receiving our observations. The Office received 107,669 contracts during fiscal years 2002-03 and 120,614 in 2003-04.

Registry of Irregularities Related to Public Funds and Property Informed by Government Entities

We instituted a computerized registry system during the period 1994-95 in order to record the information received from the various government entities regarding the loss of public funds and property. This computerized system was established in compliance with the provisions of Law No. 96 of June 26, 1964, as amended. The system's primary function is to collect and store data, which could facilitate our fiscal



responsibility. This information is also provided to the Treasury Department and the Justice Department as prescribed by law.

In compliance with the requirements of Law No. 96, *supra*, during fiscal year 2003-04, our Office received information on 2,807 cases totaling \$7,841,841. These cases are subject to further examination when the corresponding government entities are audited.

Result of Operations

Budget

The original budget assigned to the Office for fiscal year 2003-04 was \$37,161,000. On December 2004 the Treasury Department of Puerto Rico reimbursed \$1,450,158 for payroll and related costs due to a salary increase to public employees of the Commonwealth of Puerto Rico. This action increased the budget to \$38,611,158 a 10% increase over the budget assigned for the previous fiscal year. The Office spent and encumbered \$36,916,646, leaving a balance not reserved of \$1,694,512. This balance is available for non-recurring expenses for a three-year period, according to Law No. 230 of July 23, 1974, as amended, known as the Puerto Rico Government Accounting Act. Specific information is presented in the Statistical Section of this report. (Chart 1)

Reports Issued

During fiscal year 2003-04, our Office issued 200 reports. These reports involved audits that revealed administrative deficiencies, irregularities or illegal acts in the transactions involving public funds and property. By June 30, 2004, the aforementioned reports were sent to the Governor, the President of the Senate, and the Speaker of the House of Representatives. (Chart 2 and 3)

Sixty-eight percent (68%) of the reports (135) were issued during fiscal year 2003-04, less than a year after the fieldwork was concluded.

Human Capital

As of June 30, 2004 the Office had 635 occupied positions, or 98% out of 644 authorized positions. Four hundred twenty-eight 428 (67%) were auditors and 207 (33%) were support personnel. Support personnel consist of legal counsels, administrative staff, and other professionals (Chart 4). During 2003-04, 15 auditors and 6 support employees resigned or retired, while 32 auditors and 17 support personnel were hired. In addition, the Office hired 33 temporary employees 28 of which participated in the Summer Internship Program. A grand total of 1,121,105 hours were dedicated to audits, administrative and office work, training, compensated absences, and other activities. (Chart 5)

Training

The Office has established an internal regulation that requires support personnel a minimum of 15 hours of continued education annually. Auditors are required a minimum of 40 hours per year, 24 of which have to be in areas related to the profession. In case of the Auditors of the Information Technology Audit Division, 20 hours have to be in computer information system.

During 2002-04, 25,964 hours were dedicated to training and education. Seminars and Conferences in Auditing, TQM and recent development in Information Technology have been a priority.

Financial Information

Internal Controls

The Office is responsible for establishing and maintaining an internal control structure designed to ensure that its assets are protected from loss, theft, or misuse and that adequate accounting data is compiled



to allow for the presentation of financial statements in accordance with generally accepted accounting principles. The internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that, (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of cost and benefits requires estimates and sound management judgment by administrators.

Our Office has an Audit Committee to strengthen the independence, integrity, and trust of the Office's internal auditing activity and the transparency in its fiscal processes and transactions. As per regulation, the members of the Committee are distinguished professionals in the private sector.

Budgetary Controls

The Office maintains an encumbrance accounting system to accomplish budgetary controls. As demonstrated by the financial statements and schedules included in the financial section of this report, the management of the Office continues to meet its responsibility for sound financial administration, following the norms of austerity and modesty.

Independent Audit

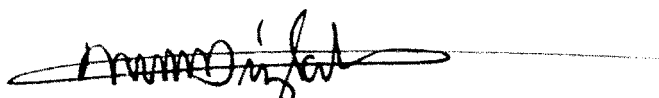
An independent certified public accounting firm conducted an audit of the financial statements of the Office. Pannell Kerr Forster, LLP, an independent accounting firm, performed the audit for the fiscal year ending June 30, 2004. The report of the Independent Auditors on the financial statements of the Office is included in the financial section. The accounting firm performed the audit for the fiscal year ended June 30, 2004 at the time expected and the Office received the certified financial statements on September 15, 2004.

Financial Reporting

The Office complies with financial reporting requirements.

We count on your cooperation to improve the oversight function and administration of public funds and property.

Respectfully submitted,



Manuel Díaz Saldaña
Comptroller





Principal Officers

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OFFICE OF THE COMPTROLLER

PRINCIPAL OFFICERS AS OF
JUNE 30, 2004

MANUEL DÍAZ SALDAÑA, CPA, CFE
Comptroller

HERIBERTO COLÓN ACEVEDO, CFE
Deputy Comptroller

JAMIEL MIRANDA MATOS, P.E.
Assistant Comptroller
Strategic Planning, TQM,
and Administration Area

ALFONSO M. CHRISTIAN
CANCEL, ESQ.
Assistant Comptroller
Legal Affairs Area

ALINA TORRES MARRERO, CFE
Assistant Comptroller
Anti-Corruption Strategies Area

NATANAEL ARROYO CRUZ, CFE
Special Aide
Peer Review

MYRIAM J. FLORES SANTIAGO,
CFE
Internal Audit Director

LISANDRA RIVERA RIVERA
Press Officer

AUDIT DIRECTORS

JOSÉ GONZÁLEZ DELGADO, CFE
Director, Audit Division "A"
Department and Agencies

ORLANDO CALDERÓN SERRANO, CFE
Director, Audit Division "B"
Department and Agencies

MADELINE SANTOS COLÓN, CFE
Director, Audit Division "E"
Department and Agencies

LOURDES DÍAZ VALCÁRCEL, CFE
Director, Information Technology
Audit Division

CARLOS O. RIVERA GONZÁLEZ, CFE
Director, Municipalities
Audit Division

LUIS A. CORREA TORRES, CFE
Director, Public Corporations
Audit Division

SUPPORT DIRECTORS

NILSA T. AÑESES LOPERENA, ESQ.
Director, Assistance in Litigation
and Forensic Audits Division (DALAF)

MARÍA A. BETANCOURT CABRET, MBA
Director, Finance and General Services Division

LILLIAN SÁNCHEZ PÉREZ
Director, Human Capital Division

HELVIA MAYORAL AMY
Director, Information Division

RAFAEL GUSTAVO PÉREZ, MBA, CISSP
Director, Information Systems Division

NILSA T. AÑESES LOPERANA, ESQ.
Director, Legal Division

ANNETTE CINTRÓN MALDONADO
Director, Professional Development and External
Orientations Center



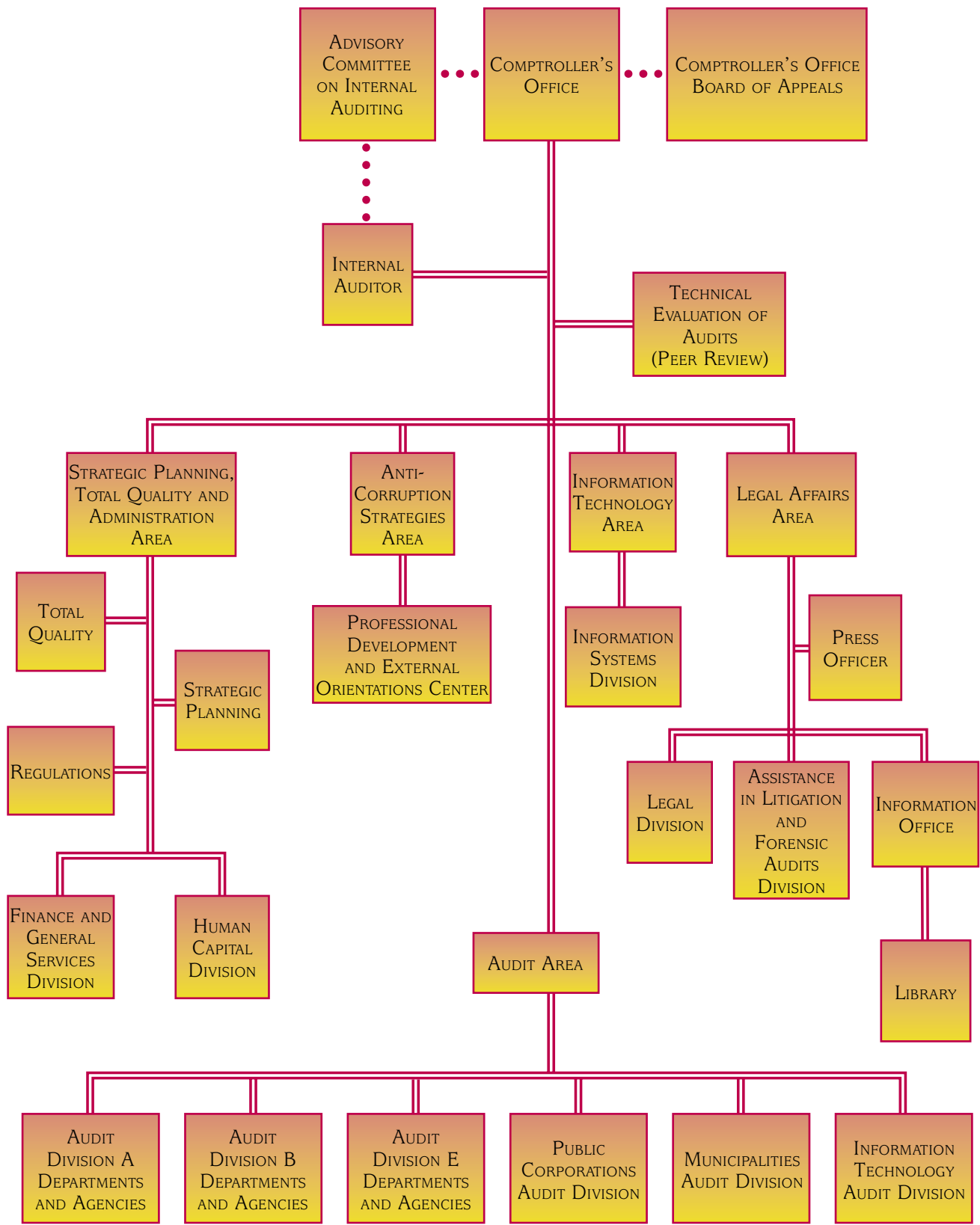
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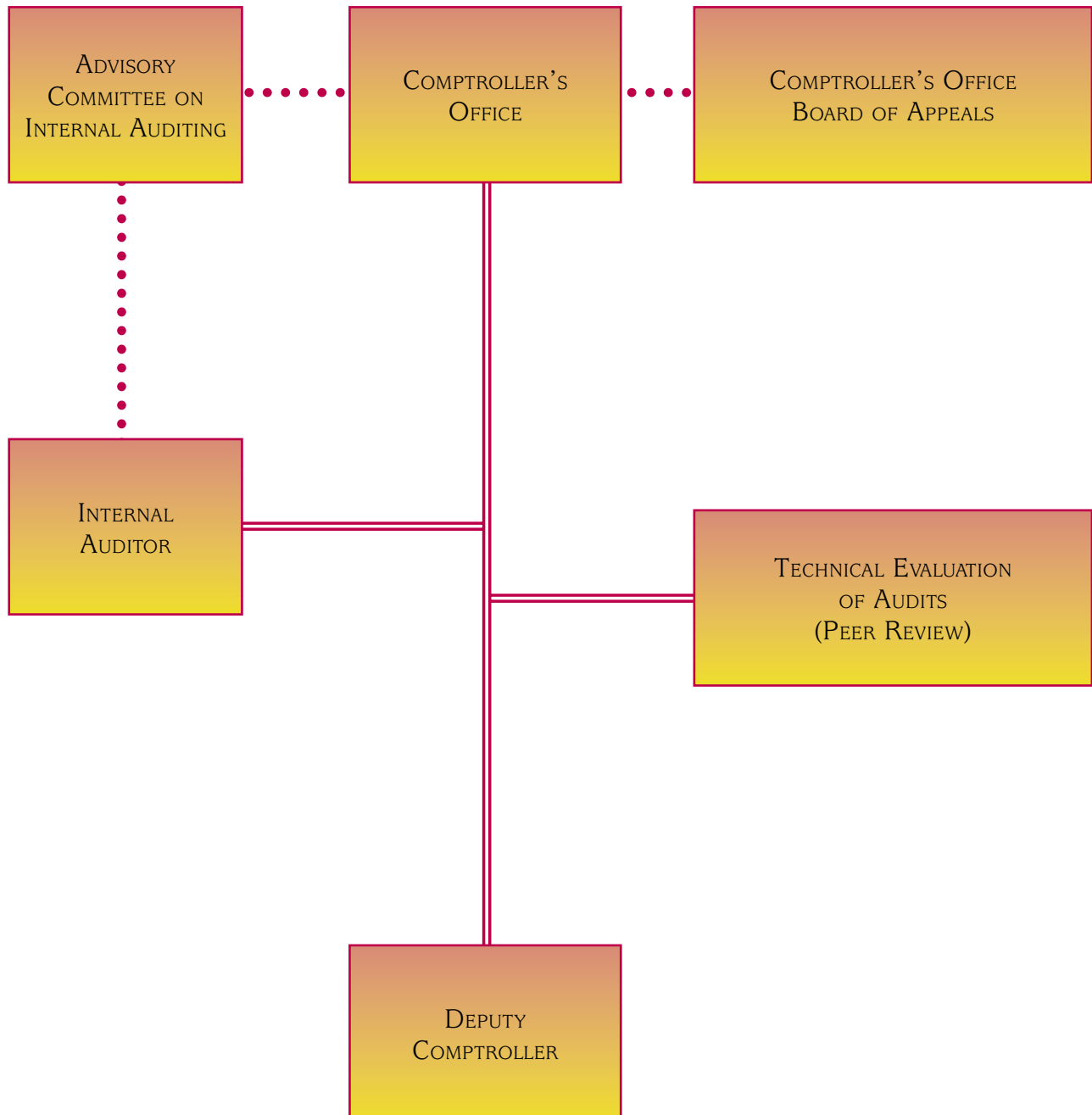
Organizational Charts

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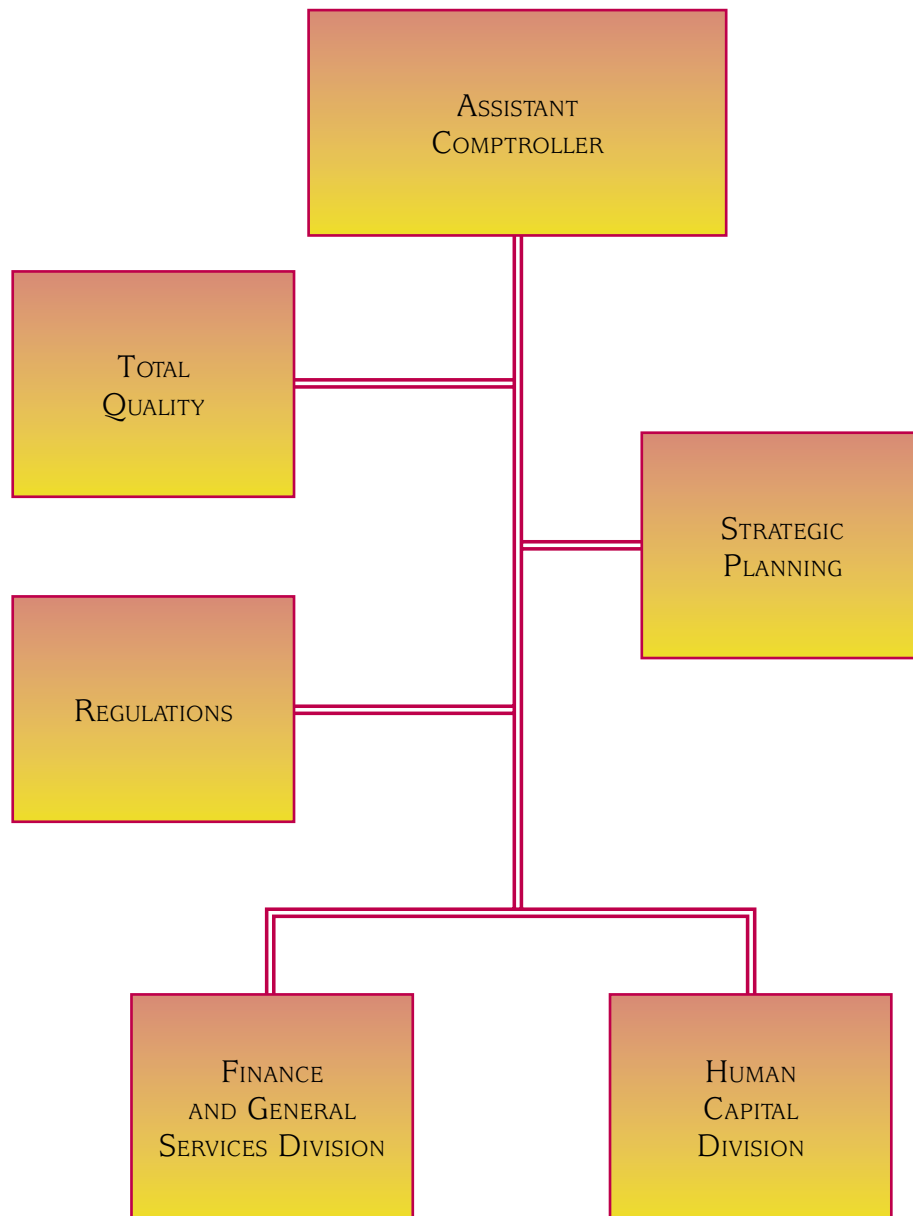
ORGANIZATIONAL CHART



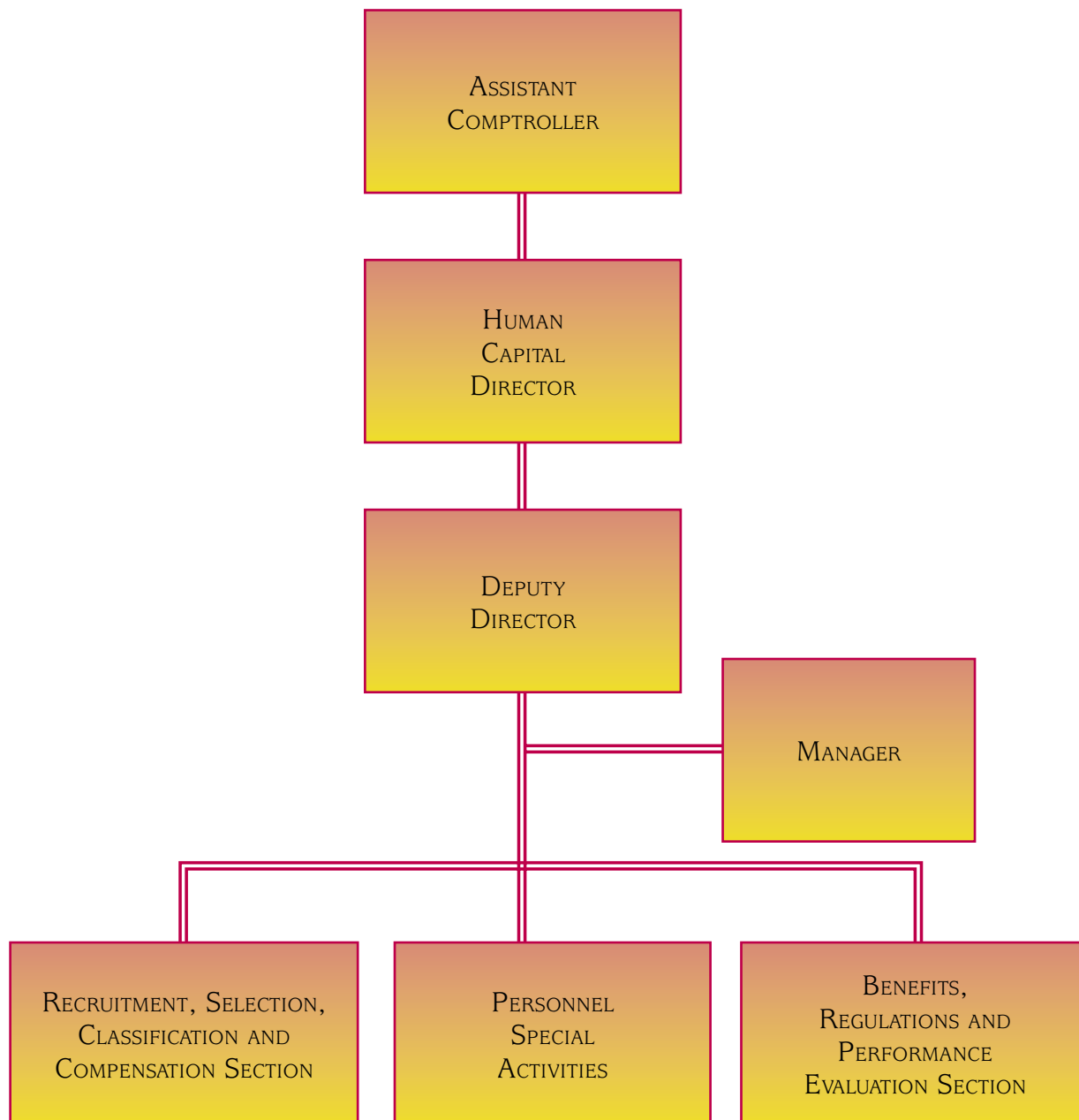
COMPTROLLER'S OFFICE



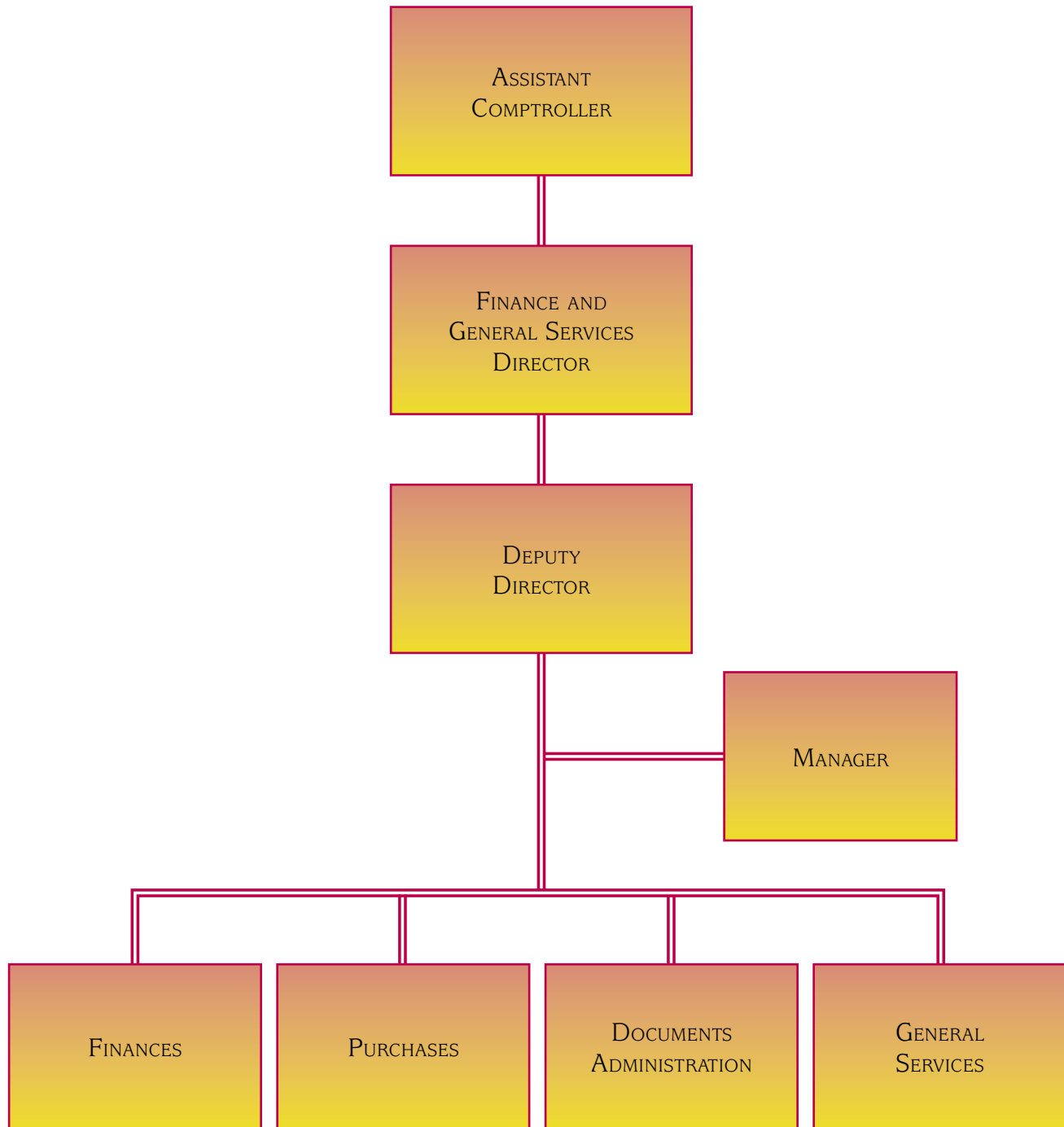
STRATEGIC PLANNING, TOTAL QUALITY AND ADMINISTRATION AREA



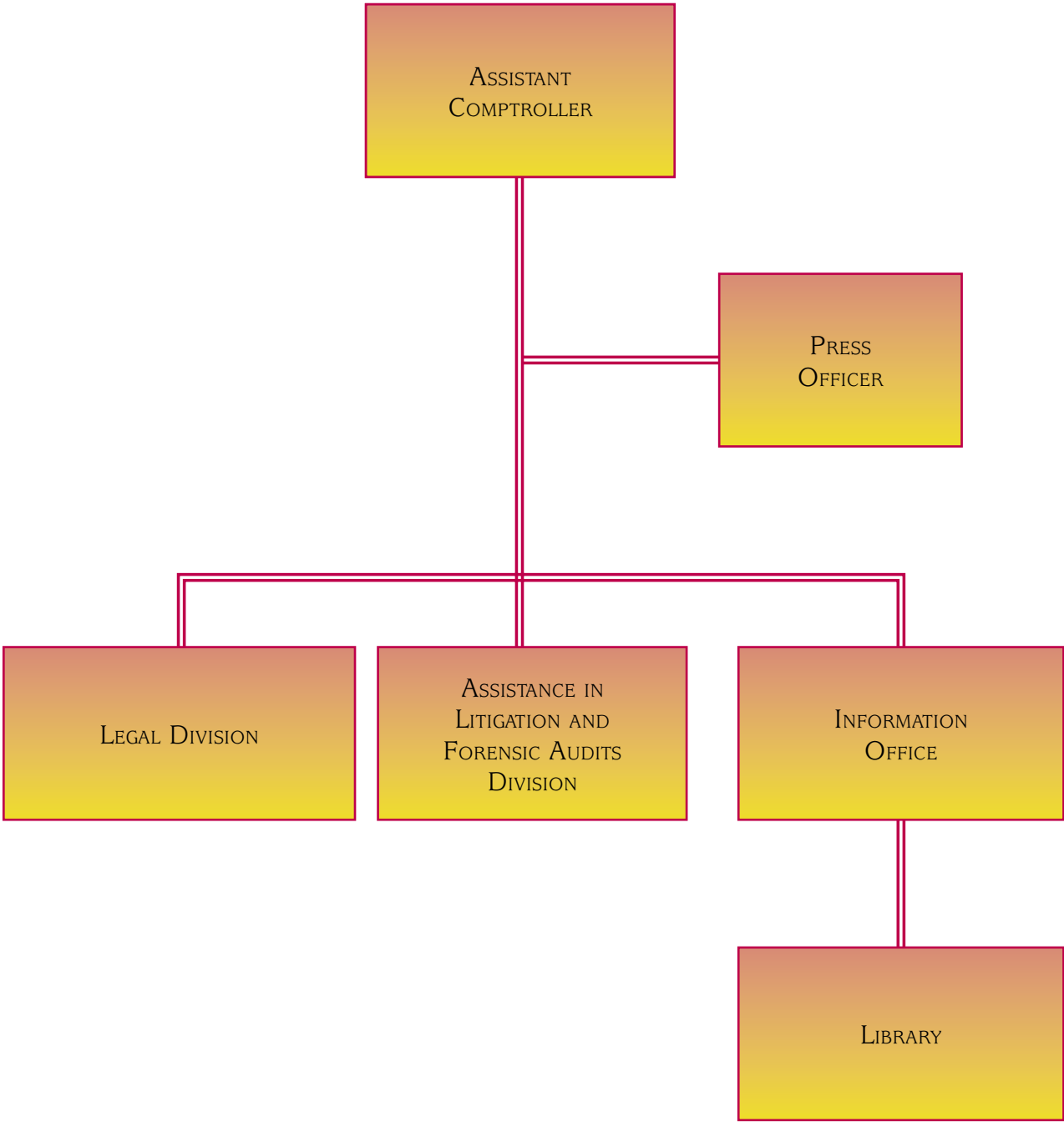
STRATEGIC PLANNING, TOTAL QUALITY
AND ADMINISTRATION AREA
HUMAN CAPITAL DIVISION



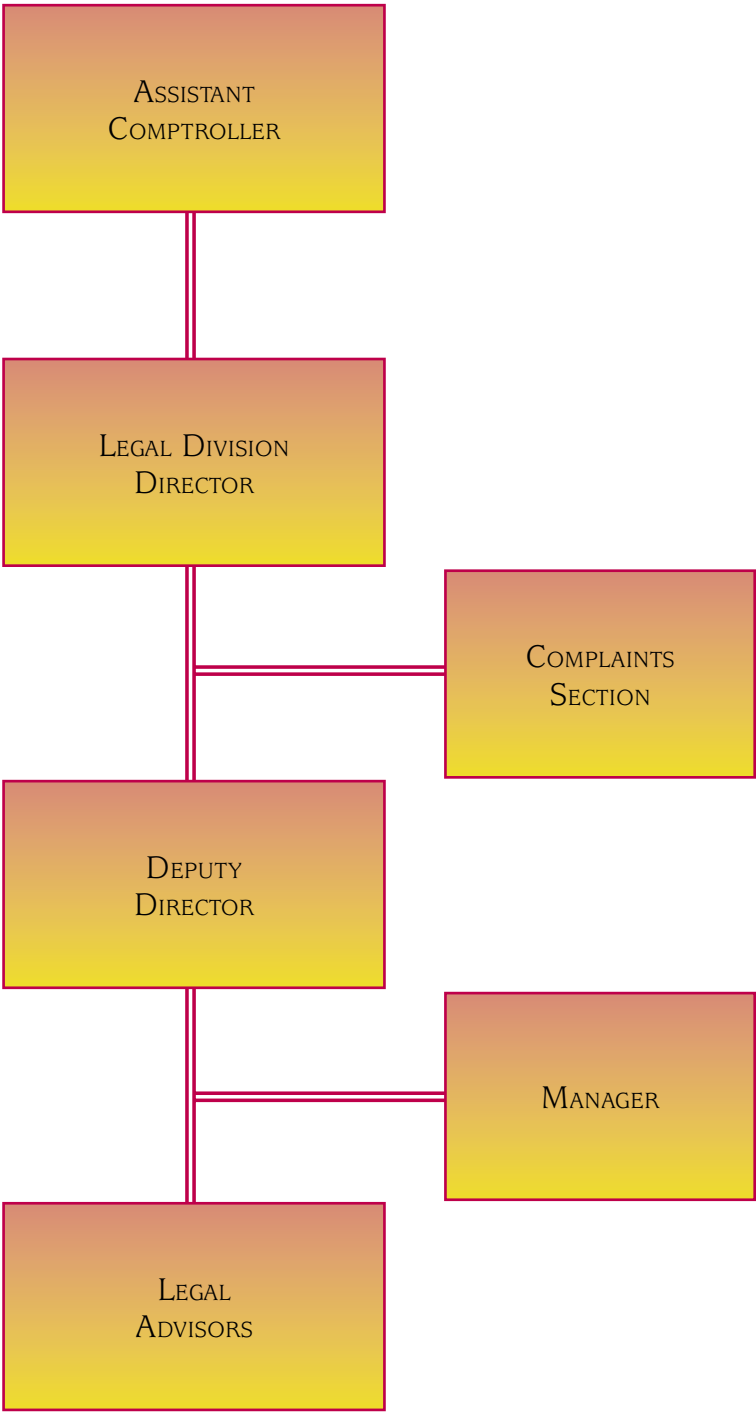
STRATEGIC PLANNING, TOTAL QUALITY
AND ADMINISTRATION AREA
FINANCE AND GENERAL SERVICES DIVISION



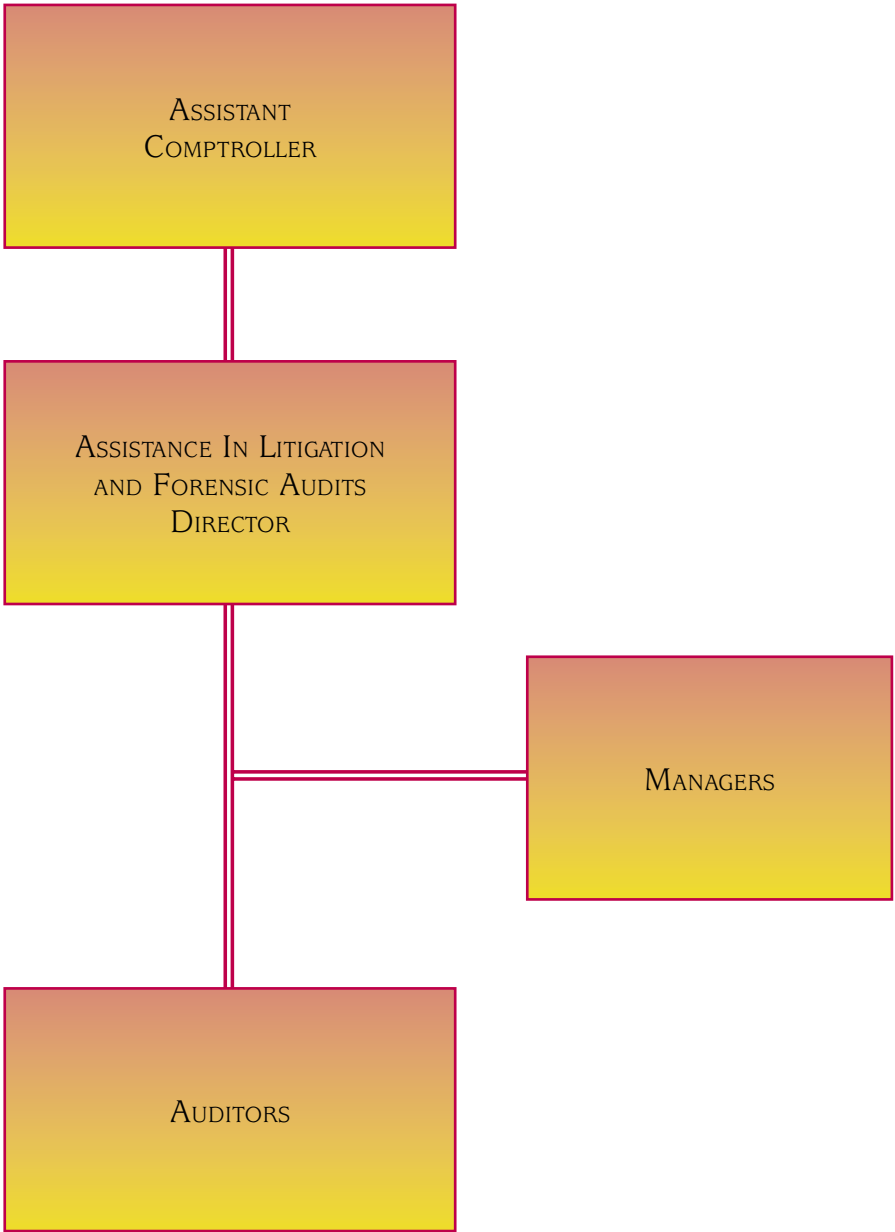
LEGAL AFFAIRS AREA



LEGAL AFFAIRS AREA
LEGAL DIVISION



LEGAL AFFAIRS AREA
ASSISTANCE IN LITIGATION
AND FORENSIC AUDITS DIVISION



**LEGAL AFFAIRS AREA
INFORMATION DIVISION**

ASSISTANT
COMPTROLLER

DIRECTOR
OF INFORMATION

INTRANET, INTERNET
AND MULTIMEDIA
GRAPHIC DESIGNERS

LIBRARY



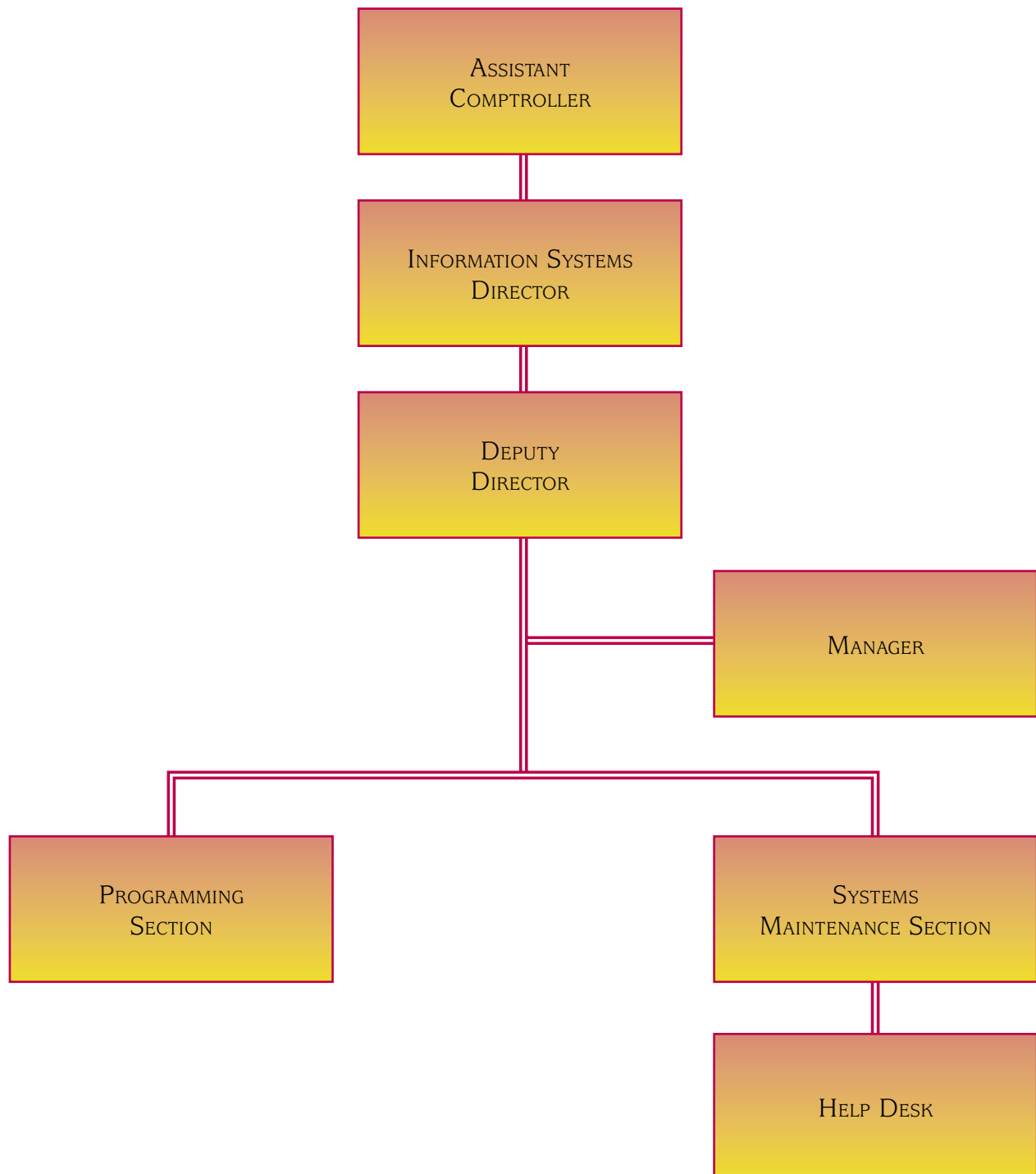
ANTI-CORRUPTION STRATEGIES AREA

ASSISTANT
COMPTROLLER

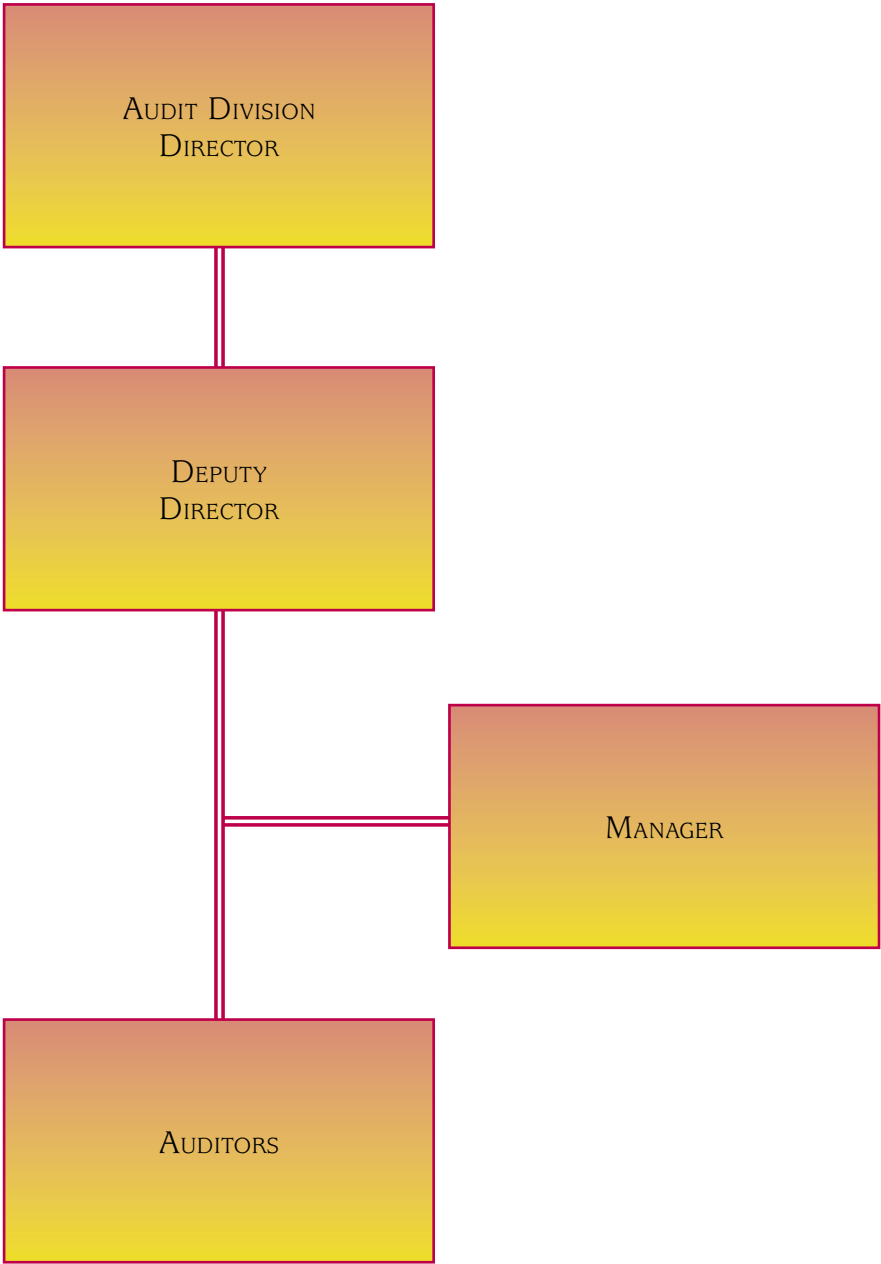
PROFESSIONAL
DEVELOPMENT
AND EXTERNAL
ORIENTATIONS CENTER



INFORMATION TECHNOLOGY AREA
INFORMATION SYSTEMS DIVISION



AUDIT AREA
AUDIT DIVISIONS





Financial Section



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INDEPENDENT AUDITORS' REPORT

Hon. Manuel Díaz Saldaña
Comptroller
Commonwealth of Puerto Rico
Office of the Comptroller

We have audited the accompanying financial statements of the governmental activities of the Office of the Comptroller of the Commonwealth of Puerto Rico (the Office) as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Office's management. Our responsibility is to express an opinion 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 Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the Office is for financial reporting purposes a part of the Commonwealth of Puerto Rico. The accompanying financial statements present only the Office of the Comptroller's financial data and are not intended to present fairly the financial position of the Commonwealth of Puerto Rico and the results of its operations in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the Office of the Comptroller of the Commonwealth of Puerto Rico at of June 30, 2004, and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Pannell Kerr Forster, LLP

*Hon. Manuel Díaz Saldaña
Comptroller
Commonwealth of Puerto Rico
Office of the Comptroller
Page 2*

The Management's Discussion and Analysis on pages 3 to 6 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information and, in our opinion, based on our audit, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with Government Auditing Standards, we have also issued a report dated September 3, 2004, on our consideration of the Office of the Comptroller's internal control over financial reporting and our tests of its compliance with certain provision of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.



September 3, 2004

Pannell Kerr Forster
License No. 22
Expires December 1, 2004

Pannell Kerr Forster, LLP

OFFICE OF THE COMPTROLLER OF PUERTO RICO

Management's Discussion and Analysis

The Office of the Comptroller, an agency principally assigned to the Legislative Branch of the Commonwealth of Puerto Rico, 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, 2004.

Financial Highlights

- The total liabilities of the Office of the Comptroller at the close of the fiscal year ended June 30, 2004 amounted to \$10,817,732 comprised of the accrual required under GASB No. 34 for vacations and sick leave in the amount of \$10,284,752 and \$532,980 due to creditors. The liabilities exceeded its assets by \$5,380,679 (net deficit) principally due to the aforesaid accrual for vacations and sick leave. The Office of the Comptroller 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 of the Comptroller's total change in assets increased by \$1,254,096. The total amount of this increase is attributable to the combination of two factors: (1) the budget approved by the Legislature of the Commonwealth of Puerto Rico for the fiscal year ended June 30, 2004 (\$38,611,158) was approximately ten percent (10%) higher than the one approved for the fiscal year ended June 30, 2003 (\$35,063,490) ; and (2) the level of expenses for fiscal year ended June 30, 2004 (including depreciation) was only one percent (1%) lower than the one for fiscal year ended June 30, 2003, that when compared with the increase in the Office's budget, resulted in a higher amount of cash available or economies at June 30, 2004. At June 30, 2004, the Office reported cash by \$3,711,780, which was \$1,599,410 higher than cash of \$2,112,370 at June 30, 2003.
- The final Budget of the Office of the Comptroller of Puerto Rico for the fiscal year 2003-2004 was \$38,611,158. The initial budget of \$37,161,000 increased during the fiscal year by \$1,450,158. The increase corresponds mainly due to the salary increase approved by the Governor of the Commonwealth of Puerto Rico during the fiscal year 2003-2004, to all public employees.

The Office achieved an economy of \$1,694,512 in its management of the general fund budget for the fiscal year 2003-2004.

Overview of the Financial Statements

This Management's Discussion and Analysis document is intended to serve as an introduction to the Office of the Comptroller's basic financial statements. The Office of the Comptroller's basic financial statements comprises three components: 1) Government-wide Financial Statements on all of the Activities of the Office, 2) Fund Financial Statements, and 3) Notes to the Financial Statements. This report also contains other supplementary information, in addition to the basic financial statements themselves.

OFFICE OF THE COMPTROLLER OF PUERTO RICO

Management's Discussion and Analysis (continued)

Government-wide Financial Statements: The Government-wide Financial Statements are designed to provide readers with a broad overview of the Office of the Comptroller's financial position, in a manner similar to a private-sector business.

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

The Statement of Activities presents information showing how the Office of the Comptroller's net assets changed during the most recent fiscal year. All changes in net assets 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 of the Comptroller that are supported by legislative assessments from the General Fund of the Commonwealth of Puerto Rico (governmental activities). The Comptroller of Puerto Rico has the constitutional duty to ascertain that all revenues, accounts and disbursements of the Commonwealth of Puerto Rico and all operations involving public funds and public property were performed as stated in Article III of the Constitution of the Commonwealth of Puerto Rico, Act No. 9 of July 24, 1952, as amended.

The Government-wide Financial Statements of the Office of the Comptroller's finances can be found on pages 7 to 8 of this report.

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 of the Comptroller, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund of the Office of the Comptroller belongs to categories 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, governmental fund financial statements focus on near-term inflows and outflows of expendable resources, as well 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.

OFFICE OF THE COMPTROLLER OF PUERTO RICO

Management's Discussion and Analysis (continued)

Because the focus of governmental funds 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 Governmental Fund Balance Sheet and the Statement of Governmental Fund of Revenues, Expenditures, and Changes in Fund Balances provide a reconciliation to facilitate this comparison between governmental funds and governmental facilities activities.

The Office of the Comptroller maintains one individual governmental fund and adopts an annual appropriated budget for its General Fund. A budgetary comparison statement 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 financial statements can be found on pages 14 to 21 of this report.

Financial Analysis of the Government's Funds

As noted earlier, the Office of the Comptroller uses Fund Accounting to ensure and demonstrate compliance with finance-related legal requirements.

Capital assets

The capital assets of the Office of the Comptroller are those assets that are used in the performance of its functions. The investment in capital assets for the fiscal year ended June 30, 2004, amounts to \$1,678,152. The total invested in the Office of the Comptroller's capital assets for the fiscal year was approximately two (2%) percent of the assigned budget.

Major capital asset events during the current fiscal year included the following:

- The acquisition of several computer equipments for \$537,973.

Economic Factors and Next Year's Budget

The economy of Puerto Rico must be analyzed as a region within the United States economy, since it is part of the United States monetary and banking system, as well as within its territorial boundaries. The main drive of the Puerto Rico economy is a huge external sector closely tied to the flow of merchandise, tourists, and capital between Puerto Rico and the Mainland. Thus, historically, the real growth rates of the Puerto Rico economy have closely followed those of the United States economy.

OFFICE OF THE COMPTROLLER OF PUERTO RICO

Management's Discussion and Analysis (continued)

The Office adopted the 2005 fiscal year budget on July 1, 2004. The legislative appropriations for the fiscal year 2005 amount to approximately \$40,114,000.

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 General Services Division, Office of the Comptroller of Puerto Rico, PO Box 366069, San Juan, Puerto Rico 00936-6069.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
Statement of Net Deficit
June 30, 2004

	<u>Governmental Activities</u>
ASSETS	
Current assets:	
Cash held with fiscal agent (note 1)	\$ 3,711,780
Accounts receivable	<u>47,121</u>
Total current assets	3,758,901
Noncurrent assets:	
Capital assets, net (notes 1 and 2)	<u>1,678,152</u>
Total assets	<u><u>5,437,053</u></u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued liabilities	532,980
Accrued compensated absences, current (notes 1 and 2)	<u>493,280</u>
Total current liabilities	1,026,260
Noncurrent liabilities:	
Accrued compensated absences (notes 1 and 2)	<u>9,791,472</u>
Total liabilities	<u>10,817,732</u>
NET DEFICIT	
Invested in capital assets (notes 1 and 2)	1,678,152
Deficit	<u>(7,058,831)</u>
Total net deficit	<u>(5,380,679)</u>
Total liabilities and net deficit	<u><u>\$ 5,437,053</u></u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
Statement of Activities
For the Year Ended June 30, 2004

Expenses: (notes 1, 2, 3 and 4)	
Salaries and other payroll related costs	\$ 30,662,216
Meals and travel	1,472,905
Professional services	1,397,356
Insurance	62,653
Rent	1,352,691
Utilities	603,389
Non-capitalizable equipment	222,799
Depreciation	630,995
Materials and supplies	384,107
Repairs and maintenance	355,297
Miscellaneous	383,774
Trainings and continuing professional education	154,792
Suscriptions and memberships	76,053
Security services	343,319
Printing services	129,501
Postage	37,413
	<u>38,269,260</u>
Revenue (notes 1 and 2):	<u>38,611,158</u>
State Appropriation	
Change in net deficit	<u>341,898</u>
Net deficit at beginning of year (as previously reported)	(5,261,500)
Prior period adjustment (note 2)	(461,077)
Net deficit at beginning of year (as restated)	<u>(5,722,577)</u>
Net deficit at end of year	<u>\$ (5,380,679)</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
Balance Sheet - Governmental Fund
June 30,2004

ASSETS

Cash held with fiscal agent (note 1)	\$ 3,711,780
Accounts receivable	47,121
Total assets	<u>3,758,901</u>

LIABILITIES

Accounts payable and accrued liabilities	<u>532,980</u>
--	----------------

FUND BALANCE

Reserve for encumbrances	1,369,004
Unreserved	1,856,917
Total fund balance	<u>3,225,921</u>
Total liabilities and fund balance	<u>\$ 3,758,901</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER OF PUERTO RICO
Reconciliation of the Balance Sheet - Governmental Fund to the Statement of Net Deficit
June 30,2004

Total fund balance per balance sheet - governmental fund	<u>\$ 3,225,921</u>
Amounts reported for governmental activities in the statement of net deficit are different because:	
Capital assets used in governmental activities are not current financial resources and therefore are not reported in the balance sheet -governmental fund	1,678,152
Accrued compensated absences are not due and payable neither in the current period nor with current year budget resources and therefore are not reported in the balance sheet - governmental fund	<u>(10,284,752)</u> <u>(8,606,600)</u>
Total net deficit per statement of net deficit	<u><u>\$ (5,380,679)</u></u>

See notes financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER OF PUERTO RICO
Statement of Revenue, Expenditures and Changes in Fund Balance
Governmental Fund
Year Ended June 30, 2004

Revenue (notes 1 and 5):	
State appropriation	<u>\$ 38,611,158</u>
Expenditures (notes 1, 2, 3 and 4):	
Salaries and payroll related costs	29,118,191
Meals and travel	1,472,905
Professional services	1,397,356
Insurance	62,653
Rent	1,352,691
Utilities	603,389
Non-capitalizable equipment	222,799
Capital outlays	699,637
Materials and supplies	384,107
Repairs and maintenance	355,297
Miscellaneous	383,774
Training and continued professional education	154,792
Subscriptions and memberships	76,053
Security services	343,319
Printing services	129,501
Postage	37,413
Total Expenditures	<u>36,793,877</u>
Excess of revenue over expenditures	1,817,281
Fund balance at beginning of year	<u>1,408,640</u>
Fund balance at end of year	<u><u>\$ 3,225,921</u></u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
Reconciliation of the Statement of Revenue, Expenditures and
Changes in Fund Balance - Governmental Fund
to the Statement of Activities
For the Year Ended June 30, 2004

Excess of revenue over expenditures	<u>\$ 1,817,281</u>
Amounts reported in the statement of activities are different because:	
Governmental funds report capital outlays as expenditures. However, in the statement of activities , the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	68,642
Compensated absences expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in the governmental fund.	<u>(1,544,025)</u> <u>(1,475,383)</u>
Change in net deficit	<u><u>\$ 341,898</u></u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
Statement of Revenue and Expenditures and
Changes in Fund Balance - Budget and Actual
Non GAAP Budgetary Basis
Year Ended June 30, 2004

	Original Budget	Final Budget	Actual amounts in the budgetary basis	Variance Favorable (Unfavorable)
Revenue:				
State appropriations	\$37,161,000	\$38,611,158	\$ 38,611,158	\$ -
Expenditures:				
Salaries and payroll related expenditures	26,685,000	29,187,819	29,103,134	84,685
Utilities	2,317,000	684,090	599,107	84,983
Other services	3,983,000	2,229,948	1,819,299	410,649
Training and continuing professional education	45,000	65,000	57,400	7,600
Meals and travel	1,958,000	1,498,000	1,471,300	26,700
Profesional services	1,566,000	1,897,345	1,386,367	510,978
Other	607,000	1,001,358	935,100	66,258
Materials and supplies	-	615,000	524,935	90,065
Capital outlays	-	1,402,598	997,762	404,836
Printing services	-	30,000	22,242	7,758
	37,161,000	38,611,158	36,916,646	1,694,512
Net Change in fund balance	\$ -	\$ -	\$ 1,694,512	\$ 1,694,512

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements
June 30, 2004

Note 1 – Organization and summary of significant accounting policies:

Organization

The position of Comptroller of Puerto Rico was created by virtue of Article 3, Section 22 of the Constitution of the Commonwealth of Puerto Rico. The Comptroller of Puerto Rico is appointed by the Governor with the consent of the Legislature of the Commonwealth of Puerto Rico for a term of ten years.

The Commonwealth of Puerto Rico was constituted on July 25, 1952, under 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 function of the Comptroller of Puerto Rico is to audit all the revenues, accounts and expenditures of the Commonwealth of Puerto Rico, 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 Legislative Assembly or the Governor.

The Office of the Comptroller (the Office) was created by Law 9 of July 24, 1952. The Office is an entity of the Commonwealth of Puerto Rico, assigned principally to the legislative branch of the government. The administration of the Office is autonomous and is under the direction of the Comptroller of Puerto Rico.

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

The Financial Reporting Entity

The Office is for financial reporting purposes a part of the Commonwealth of Puerto Rico. Because the Office is part, for financial reporting purposes, of the Commonwealth of Puerto Rico, its financial data is included as part of the general government section in the general fund of the Commonwealth of Puerto Rico financial statements.

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

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2004

Government-wide and Fund Financial Statements

The government-wide financial statements (the statement of net deficit and the statement of activities) report information on all of the activities of the Office. The statement of activities demonstrates the degree to which the total expenses are offset by total revenues. Separate financial statements are provided for governmental funds.

Measurement Focus, Basis of Accounting, and Financial Presentation

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 when a liability is incurred, regardless of the timing of related cash flows.

The Governmental fund financial statements are 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. For this purpose, the Office considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, expenditures related to compensated absences and claims and judgments, are recorded only when payment is due.

Fund accounting

The Office reports its financial position and results of operations in a general fund which is considered a separate accounting entity. The operation of the general fund is accounted for within a set of self-balancing accounts. The general fund is the operating fund of the Office. It is used to account for all the transactions of the Office.

Cash with fiscal agent

The funds of the Office are under the custody of the Secretary of the Treasury of Puerto Rico pursuant to Act. No. 230 of July 23, 1974, as amended, known as "Commonwealth of Puerto Rico Accounting Law". The Treasury Department follows the practice of pooling cash and cash equivalents under the custody and control of the Secretary of the Treasury. The funds of the Office in such pooled cash accounts are available to meet its current operating requirements. No collateral is required to be maintained for these pooled accounts.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2004

Capital Assets

Capital assets, which include property and equipment, 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 five 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 recorded as expenditures in the governmental fund financial statements. Depreciation expense is recorded in the government – wide financial statements.

Capital assets are depreciated using the straight-line method over the assets estimated useful lives. The estimated useful lives of capital assets are as follows:

	<u>Years</u>
Equipment	5-10
Electronic equipment for data processing	5
Furniture	10
Vehicles	10

Vacation and Sick Leave

The employee of the Office are granted 30 days of vacation and 18 days of sick leave annually. Vacation and sick leave may be accumulated in excess of the maximum permitted of 60 and 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 right to compensation except for those employees with ten or more years of service, which have the right to such compensation up to the maximum allowed.

Insurance

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.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2004

Budgetary Data

The Office's budgetary system is its primary control over expenditures. The Office conducts the following procedures in order to establish the budgetary information reflected in the accompanying financial statements:

- The Office prepares its annual budget and submits it to the Legislature 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 modified accrual basis of accounting, except for encumbrances, as explained below.

The budgeted revenue presented in the Statement of Revenue, Expenditures and Changes in Fund balance-Budget and Actual, consisted of a Legislative Appropriation, by resolution, for the year ended June 30, 2004 for operational appropriations of \$38,611,158.

The primary differences between the budgetary basis and the GAAP basis are the encumbrances are presented as expenditures under the budgetary basis.

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

Expenditures according to the Statement of Revenue, Expenditures and Changes in Fund Balance-Budget and Actual	\$ 36,916,646
Plus prior year encumbrances recorded as expenditures during current year under the GAAP basis	1,140,321
Less current year encumbrances not recorded as expenditures under the modified accrual basis	<u>(1,263,090)</u>
Expenditures according to the Statement of Governmental Fund Revenue, Expenditures and Changes in Fund Balance	<u><u>\$ 39,793,877</u></u>

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER OF PUERTO RICO

Notes to Financial Statements (continued)
June 30, 2004

In August 1994, the Governmental Accounting Law of the Commonwealth of Puerto Rico, Law 230 of July 23, 1974, was amended in order to establish that all of the unencumbered funds of the governmental agencies will remain in their 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 non-recurrent expenditures and a period of three years from the closing of the fiscal year for which they pertain.

The balance of obligated funds (encumbrances) and non-obligated funds as of June 30, 2004, are composed of the following:

Fiscal Year	Obligated Funds	Non-Obligated Funds
2001-2002	\$ 2,872	\$ 47,012
2002-2003	103,042	115,395
2003-2004	1,263,090	1,694,510
	<u>\$ 1,369,004</u>	<u>\$ 1,856,917</u>

Note 2 - Capital Assets

Capital assets activity for the year ended June 30, 2004 was as follows:

	Beginning Balance as Restated	Additions	Retirements	Ending Balance
Governmental activities				
Capital assets, being depreciated:				
Equipment	\$ 311,084	\$ 103,250	\$ 58,995	\$ 355,339
Electronic equipment	3,924,349	537,973	173,273	4,289,049
Furniture	1,003,033	11,189	-	1,014,222
Vehicles	231,236	47,225	13,815	264,646
Total capital assets being depreciated	<u>5,469,702</u>	<u>699,637</u>	<u>246,083</u>	<u>5,923,256</u>
Less accumulated depreciation for:				
Equipment	275,126	56,047	58,995	272,178
Electronic equipment	2,886,741	461,832	173,273	3,175,300
Furniture	580,840	87,397	-	668,237
Vehicles	117,485	25,719	13,815	129,389
Total accumulated depreciation	<u>3,860,192</u>	<u>630,995</u>	<u>246,083</u>	<u>4,245,104</u>
Total capital assets, being depreciated, net	<u>\$ 1,609,510</u>	<u>\$ 68,642</u>	<u>\$ -</u>	<u>\$ 1,678,152</u>

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER OF PUERTO RICO

Notes to Financial Statements (continued)
June 30, 2004

On February 26, 2004, the Department of the Treasury of the Commonwealth of Puerto Rico established in the “General Instructions for the Capital Assets Module and Other Dispositions related to the GASB Statement No. 34”, that the instrumentalities of the Commonwealth of Puerto Rico should include in their financial statements presentation, only those capital assets with a unit cost of \$500 or more. As a result, the Office restated its beginning balances of capital assets and net assets invested in capital assets at July 1, 2003 by \$461,077.

The total restatement made to the beginning balances of capital assets is composed of the following:

Equipment	\$ 207,255
Electronic	226,437
Furniture	27,385
	<u>\$ 461,077</u>

Note 3 - Pension Plan

The Office participates in the Employee’s Retirement System of the Government of Puerto Rico and its instrumentalities (ERS), a multiple-employer contributory retirement plan, which covers only eligible full-time employees. The system provides retirement, death, and disability benefits and annuities to Commonwealth employees not covered by their own systems.

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 9.275% of the participants’ gross salary. Total employer contributions during the year ended June 30, 2004 amounted to approximately \$ 1,986,800.

On September 24, 1999, an amendment to Act No. 447 of May 15, 1991, which created the Retirement System, was enacted with the purpose of establishing a new pension program (System 2000). Employees participating in the current system as of December 31, 1999, may elect to stay in the defined benefit plan or transfer to the new program. Persons joining on or after January 1, 2000 will only be allowed to become members of the System 2000.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER OF PUERTO RICO

Notes to Financial Statements (continued)
June 30, 2004

System 2000 reduces the retirement age from 65 to 60 for those employees who joined the current plan on or after April 1, 1990. System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan, there are a pool of pension assets, which is invested by the System 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 (9.275% of the employee's salary) is used to fund the current plan.

For the year ended June 30, 2004, total covered payroll was approximately \$23,310,000. Covered payroll refers to all compensation paid by the Office to employees covered by the ERS on which contributions to the pension are based.

The amount of the annuity shall be one and one-half percent of the average compensation multiplied by the number of years of creditable service up to twenty years, plus two percent of the average compensation multiplied by the number of years of creditable service in excess of twenty years, for those employees covered after March 31, 1990, the annuity shall be equal to one and one-half 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.

Additional information of the System is provided in its financial statements for the year ended June 30, 2004 a copy of which can be obtained from CPA Marisol Marchand, Esq. Administrator of the Retirement Systems of the Commonwealth of Puerto Rico, P.O. Box 42003, San Juan, Puerto Rico 00949.

Note 4 - Lease Commitments

The Office rents its facilities through operating lease agreements in which the latest expires in 2007. Rent expense under such lease agreements for the year ended June 30, 2004 amounted to \$1,352,691. Future minimum lease payments as of June 30 are as follows:

2005	\$ 1,115,105
2006	257,961
2007	69,209
	<hr/>
	\$ 1,442,275

OFFICE OF THE COMPTROLLER OF PUERTO RICO

Notes to Financial Statements (continued)

June 30, 2004

Note 5 - Legislative Appropriations

The Office's principal source of revenue is legislative appropriations from the Commonwealth of Puerto Rico. Appropriations are for general operating purposes of the Office.

Note 6 - Contingencies

The Office is defendant in various lawsuits pending in court. As established by the law of Puerto Rico, the Department of Justice of the Commonwealth of Puerto Rico represents the Office in any litigation. As established by law, any unfavorable outcome against the Office will be settled by the Commonwealth of Puerto Rico and not from the Office itself. Accordingly, the Office does not recognize any accrual for any unfavorable outcome in the accompanying financial statements.

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INDEPENDENT AUDITORS' REPORT
ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Hon. Manuel Díaz Saldaña
Comptroller of the Commonwealth of
Puerto Rico

We have audited the basic financial statements of the Office of the Comptroller (the Office) as of and for the year ended June 30, 2004 and have issued our report thereon dated September 3, 2004. 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 *Government Auditing Standards*, issued by the Comptroller General of the United States of America.

Compliance

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

Internal control over financial reporting

In planning and performing our audit, we considered the Office's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses.

PANNEL KERR FORSTER, LLP

Hon. Manuel Díaz Saldaña
Comptroller of the Commonwealth of
Puerto Rico
Page 2

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting which we have reported to the management of the Office in a separate letter dated September 3, 2004.

This report is intended solely for the information and use of the Audit Committee, the Comptroller and the legislature of Puerto Rico and the people of the Commonwealth of Puerto Rico.



Pannell Kerr Forster

License No. 22

Expires on December 1, 2004

September 3, 2004

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Statistical Section





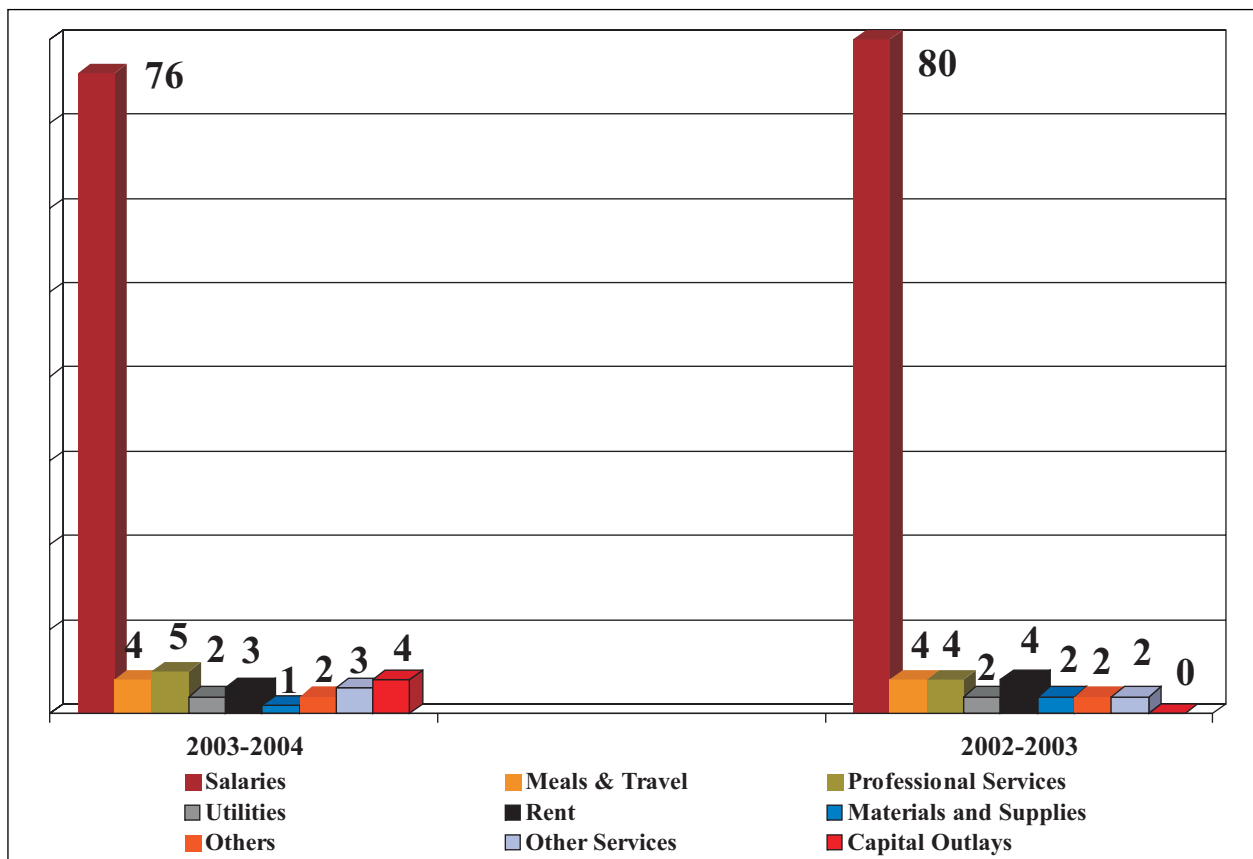
REPORT AND OPERATIONS

The table and chart that follow indicate the composition of the budget by salaries, meals and travel, professional services and others, with respect to the total legislative appropriations.

The table and chart also present a comparative picture for two consecutive fiscal years, 2003-04 and 2002-03.

Chart 1 - Budget

Description	2003-04		2002-03	
	Appropriation	Percent	Appropriation	Percent
Salaries & fringe benefits	\$29,187,819	76	\$28,099,990	80
Meals and travel	1,498,000	4	1,475,000	4
Others	1,001,358	2	581,439	2
Professional Services	1,897,345	5	1,487,259	4
Utilities	684,090	2	534,000	2
Rent	1,352,691	3	1,225,618	4
Materials and Supplies	615,000	1	773,541	2
Other Services	972,257	3	886,643	2
Capital Outlays	1,402,598	4		
Total	\$38,611,158	100	\$35,063,490	100

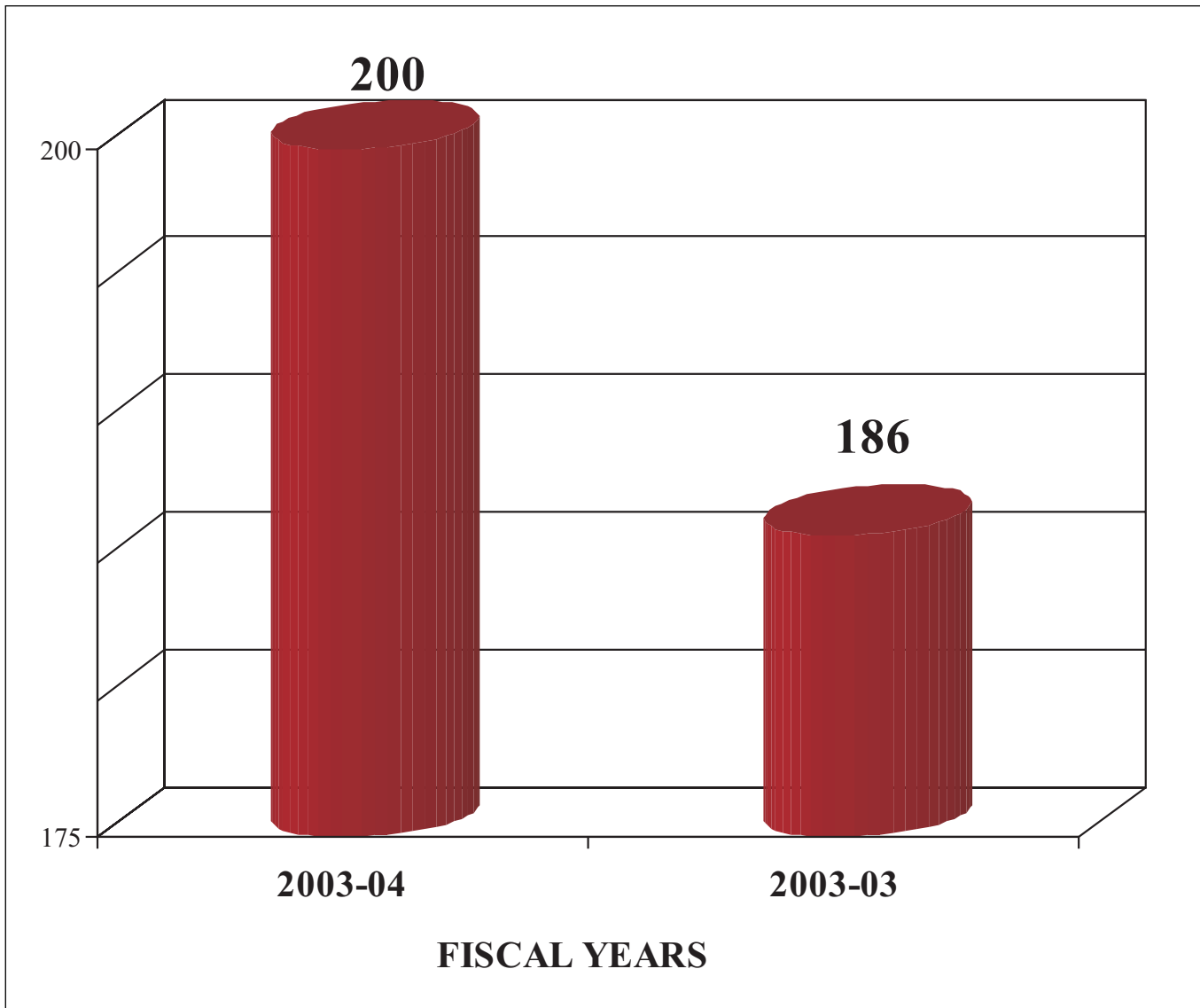


ISSUED REPORTS

During fiscal year 2003-04, our Office issued 200 reports. These reports involved audits which revealed administrative deficiencies, irregularities or illegal acts in the operation of audited units. They were completed and sent to the Governor, the President of the Senate and the Speaker of the House of Representatives by the end of each fiscal year.

Chart 2 shows the number of Issued Reports for fiscal years 2003-04 and 2002-03.

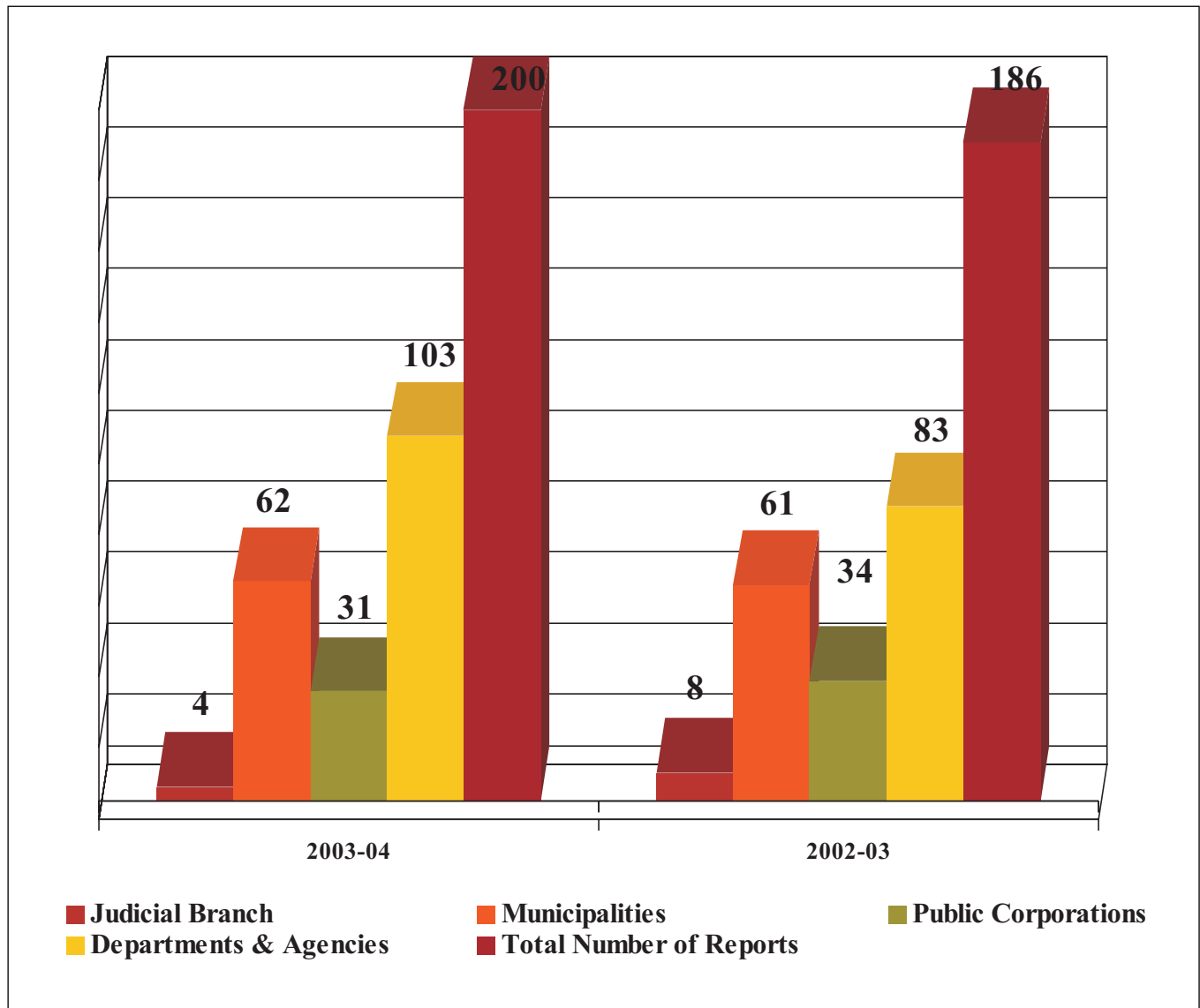
Chart 2 - Issued Reports



ISSUED REPORTS BY TYPE OF GOVERNMENT ENTITY

This chart shows the number of Issued Reports by type of governmental entity for fiscal year 2002-03 and 2003-04.

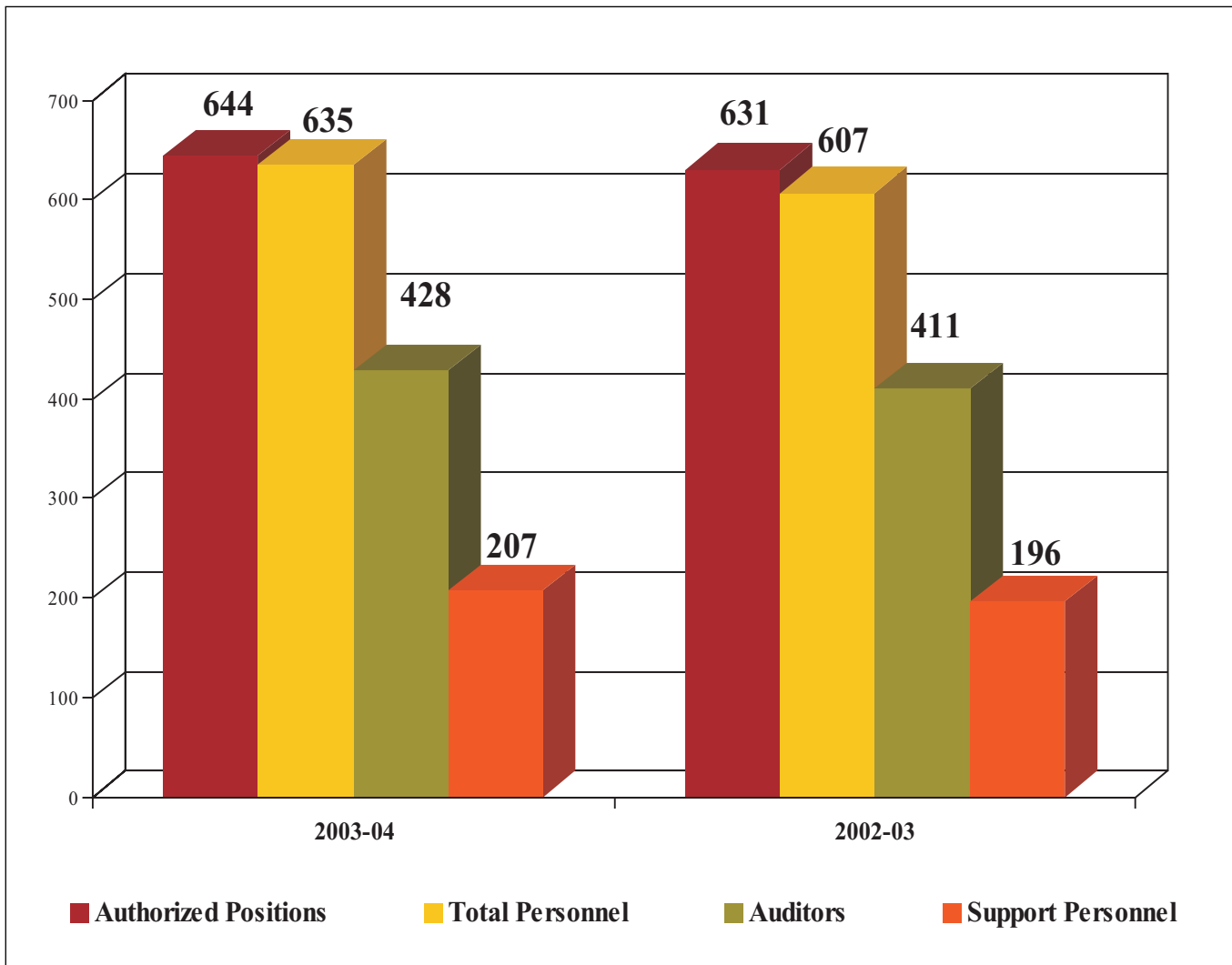
Chart 3 - Issued Reports by Entity



CAPITAL RESOURCES

This Chart shows the breakdown of audit and support personnel for fiscal years 2003-04 and 2002-03.

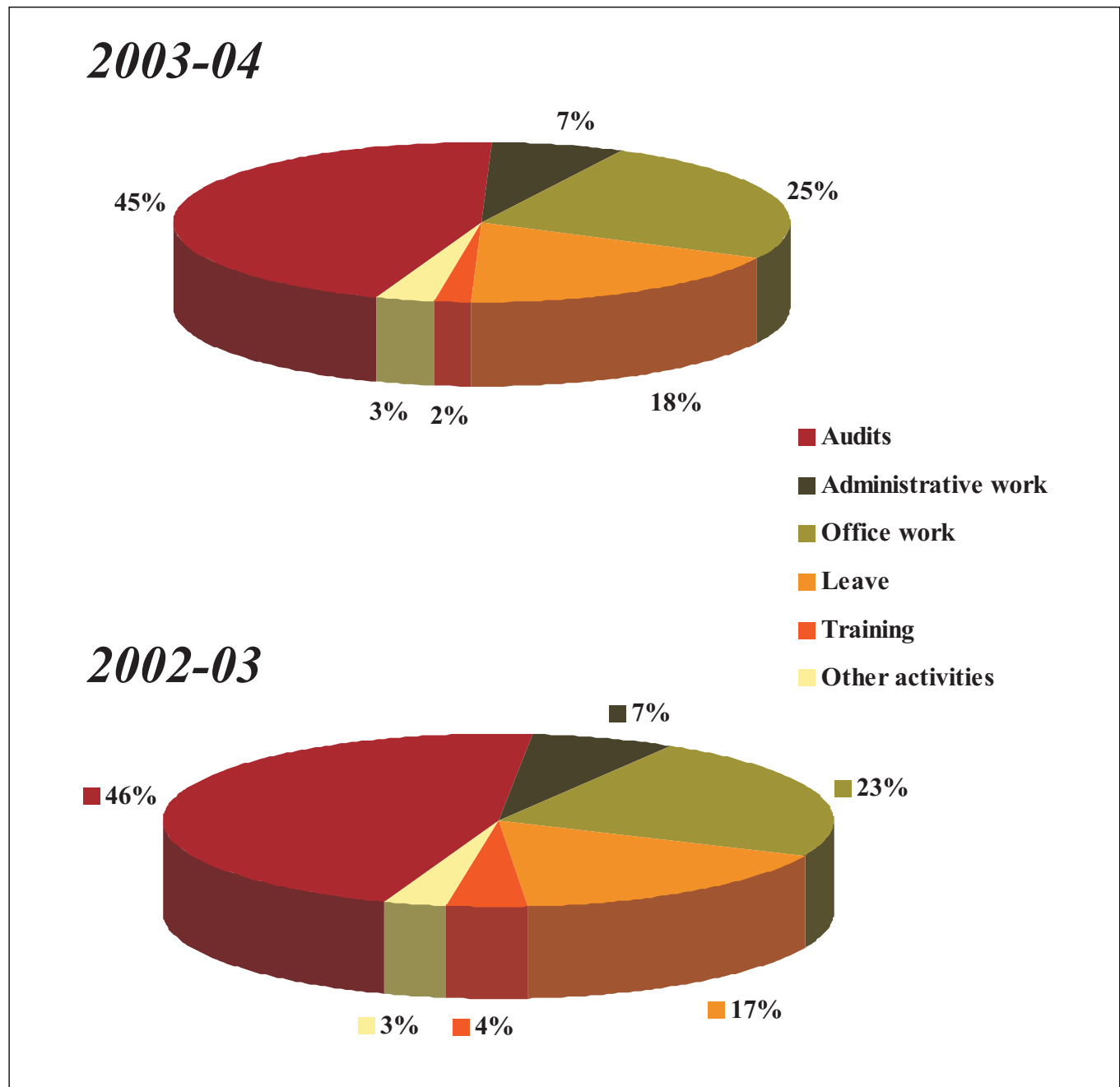
Chart 4 - Distribution of Capital Resources by Auditor and Support Personnel



TIME DISTRIBUTION

This chart shows, by percentages, a breakdown of hours dedicated to audit, administrative and office work, training, leave and other activities.

Chart 5 - Time Description by Activity During 2003-04 and 2002-03



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Other Information





INTERNAL ANTICORRUPTION POLICY

(Summary)

STATEMENT POLICY

The Office of the Comptroller of Puerto Rico is highly committed to fight corruption and fraud in the government and in internal settings.

PHILOSOPHY OF THE ORGANIZATION

All our coworkers must act according to our codes of ethics and behavior, as well as the applicable norms and regulations of their respective working areas. Zero Tolerance to Corruption (CTC 2000) has been established through this policy.

INTERNAL, CONTROL POLICY

- Code of Ethics
- Code of Behavior
- Regulations
- Procedures
- Norms for the safety of our computerized systems
- Norms for confidentiality of the Office information and processes
- Annual renewal of constitutional commitment
- Annual certification of profit making activities and of rendering Income Tax forms.

CODE OF ETHICS COMMITTEE

This Committee is responsible of giving immediate attention to any notification or allegation of actions that constitute fraud or corruption.

PREVENTION PHASE

Recruiting: The recruiting of personnel must be ruled by the regulations and procedures approved by the Comptroller.

Personnel Responsibility: They are required to notify our Ethics Committee of the possibility of an action that constitute corruption, which they are aware of.

Regulation: Effective internal controls are established in regulations, systems and procedures of this Office to warrant purity in administrative, fiscal and financial processes.

Internal Controls: The managerial personnel is responsible for watching that controls established in their respective working areas, are effective and efficient and are updated. Our auditors from time to time audit processes in order to determine if the controls are adequate and efficient.

External Controls: The Office is subject to monitoring by external entities, in order to warrant a healthy public administration, as follows:

- Advisory Committee on Internal Audits shall be able to make audits of the Office and have access to all the accounting files.
- External Auditors shall not be contracted for more than three consecutive years.
- Regulations for providers of property or services policies were approved to regulate relations between the Office and providers.
- Government Ethics Office (GEO) – both the Comptroller and designated personnel thereby, render financial reports to GEO.

NOTIFICATION OF ACTIONS THAT CONSTITUTE CORRUPTION

Direct communication to the Ethics Committee guarantee:

- Consistency in handling information
- Adequate, objective and independent investigation
- Protection for coworkers and the interest of the Office.

Depending on the magnitude of the action committed, the Comptroller determines if the case is referred to other government entities, such as:

- Police Department
- Department of Justice
- Government Ethics Office
- Department of the Treasury

CONFIDENTIALITY

Laws No. 426 of November 7, 2000 and No. 14 of April 11, 2001, provide protection of the rights of accusing public employees and officials, complainants or witnesses of alleged corruption action.

CONTINUOUS EDUCATION

We established a policy of requiring a minimum of 15 annual credit hours, to support personnel and 40 credit hours to auditing staff to expand their knowledge on internal controls, laws, regulations, fiscal norms and procedures, among others.

Revised on March 8, 2003.

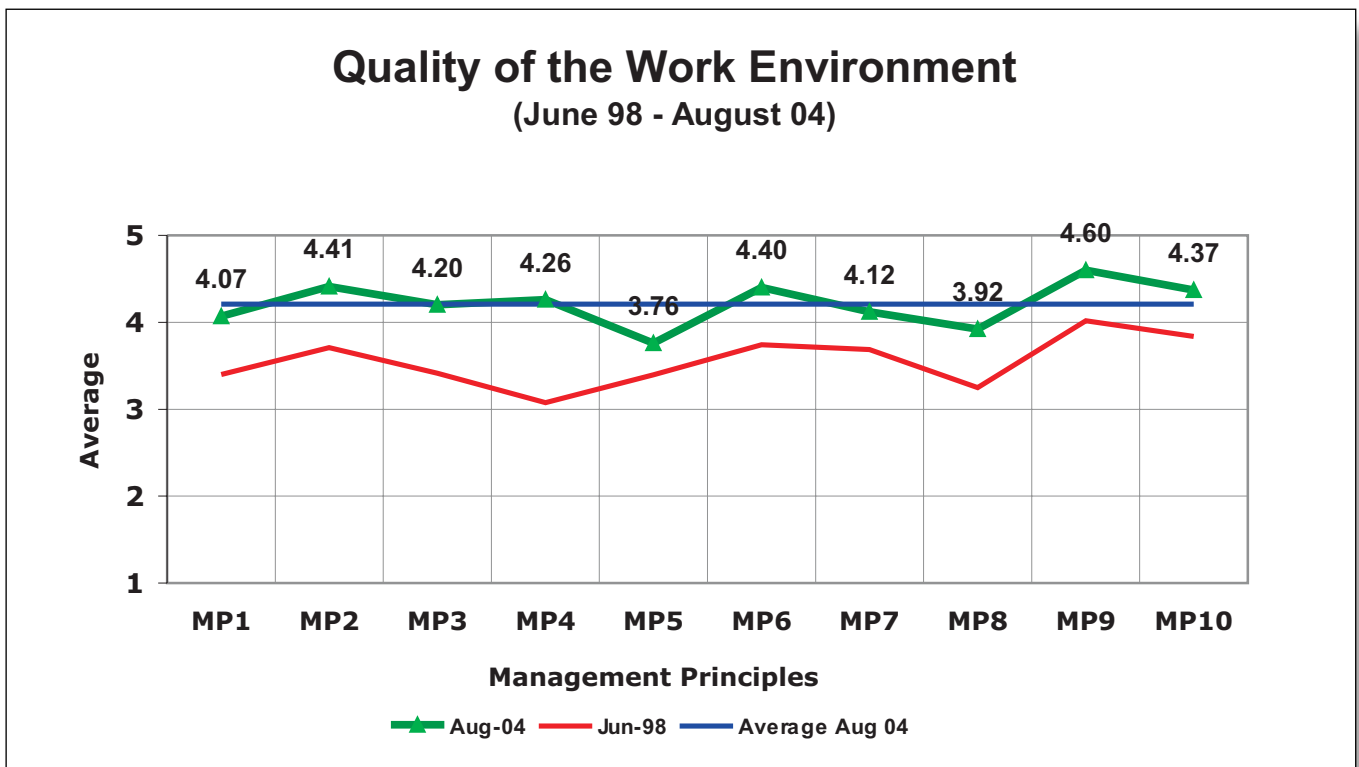
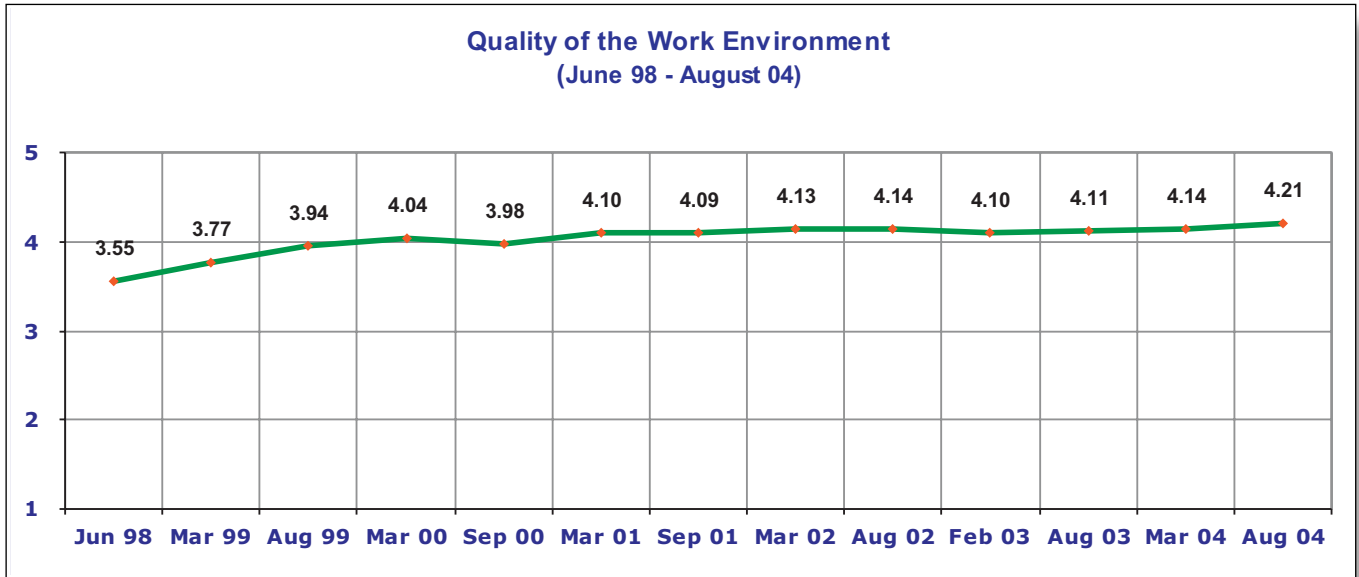
(Sgd) *Manuel Díaz Saldaña*
Comptroller of Puerto Rico

Zero Tolerance to Corruption





MEASUREMENT OF THE QUALITY OF THE WORK ENVIRONMENT



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