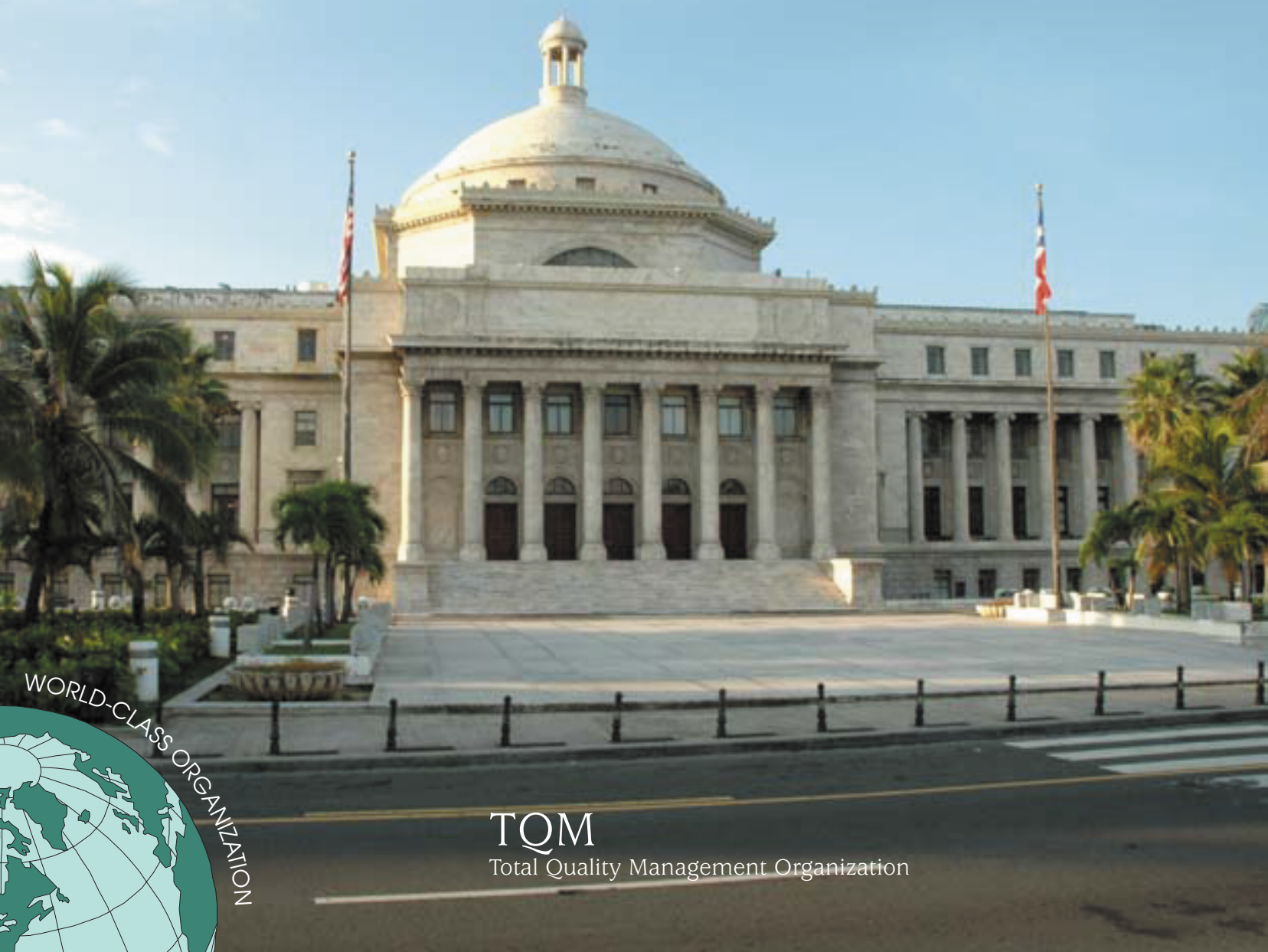


COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For Fiscal Year Ended June 30, 2005






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

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.

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

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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, 2005



Prepared by the Office of the Comptroller of Puerto Rico

Manuel Díaz Saldaña, CPA, CFE
Comptroller

November 15, 2005

Comptrollership at your service...



Puerta de San Juan, San Juan, Puerto Rico

Cover: Puerto Rico Capitol Building, San Juan, Puerto Rico (North facade)

Back cover: Puerto Rico Capitol Building, San Juan, Puerto Rico (South facade)

Photos: AG Photography

Design and Digital Composition: Héctor R. Pérez

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.

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COMMONWEALTH OF PUERTO RICO OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT For Fiscal Year Ended June 30, 2005

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Introduction Section



Capilla del Cristo, San Juan, Puerto Rico





El Morro, San Juan, Puerto Rico

Letter of Transmittal



Commonwealth of Puerto Rico
Office of the Comptroller

Manuel Díaz Saldaña
Comptroller

November 15, 2005

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, 2005. 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 chart.

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 3,808,610 in 2000. The Puerto Rico Planning Board estimates that by 2006, the population will be 3,956,003.



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 created 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. The Office has divided all the government entities of the Executive, Legislative and Judicial branches into 2,253 units for auditing or examination purposes. This figure includes departments, agencies, public corporations, municipalities, and 1,562 community schools.

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 findings 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 2004-2007 and an Annual Operations Plan. The Strategic Plan is divided into five Focal Areas, with several objectives and initiatives that are being developed and implemented 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 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 202 audit reports during the fiscal year. Among the most important reports are:
 - a. Audit Reports DB-05-11 and DB-05-12 of December 17, 2004, regarding the Utilization of Public Funds in Activities and Operations of the Association and Federation of Mayors, respectively.
 - b. Audit Report DA-05-19 of March 4, 2005, concerning a Survey about the Use of Public Funds for Training of Employees in the Public Sector.
 - c. Audit Report CP-04-27 of June 15, 2005, regarding the Water & Wastewater Plants of the Puerto Rico Aqueducts and Sewer Authority.
 - d. Audit Report CP-05-31 of June 23, 2005, regarding the Puerto Rico Electric Power Authority.
 - e. Twenty-three audit reports regarding the Community Schools.
2. Implemented the TeamMate System, an electronic program designed to reduce the use of paper in the audit function in most of the audits started after February 2005.
3. Continued with our strategy of evaluating the Campuses and Central Administration of the University of Puerto Rico, the Municipalities and Consortiums on their compliance with certain criteria established by our Office to improve their respective administrations.
4. Designed and improved an Intranet site to deal with audit issues.



5. Published in our Internet page all audit reports released by the Office since July 1997.
6. The Comptroller of Puerto Rico made a presentation at the International Governmental Financial Management Summit related to Building a Climate for Transparency and Accountability.
7. On March 7, 2005, the OCPR.HOTLINE was established to receive and investigate internal complaints related to improper or illegal acts, or possible infringement of internal norms and regulations.
8. In March 2005, the Comptroller of Puerto Rico participated in a meeting with the Domestic Working Group of the Government Accountability 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 government services.

Education and Orientation

1. Offered lectures to 1,448 elected officials on the proper use of public funds and property 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 on sound public administration to 2,606 government officials and employees. Among others, presentations were made to internal auditors of public agencies and municipalities, to accountants and to finance directors of the municipalities and consortiums.
4. Participated in national and international meetings and conferences related to our investigative and preventive functions, among them: International Governmental Financial Management, International Congress of Supreme Audit Institutions (INCOSAI), TeamMate Forum, American Society for Training and Development (ASTD), National Association of State Auditors, Comptrollers and Treasurers (NASACT).
5. Developed and offered training to our personnel in order to comply with hours of continued education required in our Office.

Strategies Developed to Further Improve Public Administration

1. In May 2005, we published the pamphlet **Non-Profit Organizations: Use of Property and Public Funds**.
2. Published **Circular Letter OC-05-18** of May 27, 2005 to promote the establishment of a **Prevention-Anticorruption Program** in governmental entities.
3. In May 2005, the Office published a **Summary of the Best Operational Practices Implemented by Some Municipalities**.

Customer Services

1. The establishment of the Total Quality Management Philosophy has helped us significantly advance in the continuous improvement of processes and the cultural change in the Office environment. This can be attested as follows:
 - a. The recommendations offered by the Process Improvement Teams were implemented, thus improving and increasing the efficiency of 159 processes, 69% of the 230 Office processes.
 - b. Completed two additional rounds of Process Improvement Teams.
 - c. Administered the Workplace Environmental Quality Survey in order to obtain the perception of



fellow-workers on the application of the Ten Management Practices adopted. Results revealed that on a five-point scale, March, 2005 findings were 4.16 points, which reflects an increase of 0.61 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, Version 3), which standardizes the instructions for the application, preparation, codification, control and distribution of all Office regulations.
3. Conducted a survey to measure Customer Satisfaction.

Human Capital

1. Trained all our fellow-workers on Detection of Illegal Use of Controlled Substances, Sexual Harassment and other forms of discrimination.
2. Complied with a statutory requirement by training all our fellow-workers regarding Government Ethics.
3. Increased fringe 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, through 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 for children of limited economic resources, clothing for Salvation Army and received donations for the tsunami victims in South Asia.
5. A Policy on Safety and Occupational Health was implemented in response to our concern for the health and safety of our personnel.
6. Participated in an international conference sponsored by the Society for Human Resources Management (SHRM).
7. From May 23 to June 10, 2005, a global consulting firm conducted a survey to measure employee engagement in the Office. The result of this survey indicates that the overall engagement level is 68%, which places the organization in the best employer zone, according to the consultant’s database of the Best Employer Companies.
8. The Caribbean Business Newspaper recognized the Comptroller of Puerto Rico, Manuel Díaz Saldaña, as the Public Sector Person of the Year 2004 for his work ethic, leadership, organizational skills and value added to the Comptroller’s Office as the main promoter of sound use of public funds in all areas of government.
9. The Office’s training rooms at the Center for Professional Development were named after the six past Comptrollers.
10. During Library Week, we exposed a commemorative plaque of Dr. Rafael de J. Cordero, first Puerto Rican Auditor and first Comptroller of Puerto Rico.

Technology

1. As part of our Technology Improvement Plan, we completed 27 programs and projects related to technology. Some of the most important are:
 - a. Implementation of imaging system for scanning documents in pdf format.
 - b. Improvement of the External Complaints System (version 1.1).



- c. Expansion of the communication web.
 - d. Installation of a redundant communication link between buildings.
 - e. Improvement by 30 % in response time to data backups.
 - f. Acquisition of a new server for data recovery in emergencies.
 - g. Implementation of an antiviral system for the laptop computers of the auditors.
2. Updated the Micro Information Products accounting software (**MIP**) and implemented a new version of the fixed asset management software (**FASGOV**) to improve the control and management of property.
 3. Implemented a new purchasing module (**ROC**) of the MIP Program to improve the acquisition process and reduce the use of paper.
 4. Developed a database to monitor, manage and control the progress and execution of the relevant Office projects.
 5. Implemented a new Version 3.1 for the Registry of Contracts Program and offered a training to eight agencies and municipalities selected for a pilot run.

Communication

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

Infrastructure

The Office, from the day it was created, has never had its own office building or adequate facilities that may enable a more efficient operation. It operates from six different rented buildings dispersed in the area of Hato Rey. Its central offices are located at 105 Ponce de León Avenue, San Juan, Puerto Rico.

Law No. 38 of January 10, 1999, authorizes us 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

Seminars

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

1. **Basic Total Quality** to 11 newly hired personnel. One hundred percent of our work force is fully trained.
2. **Effective Communications** to continue improving the Quality of Work Environment.
3. **How to Achieve Excellent Execution** aimed at maintaining excellence in our management team, according to our Vision of Excellence.
4. **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, five staff members participated in the 59th World Conference on Quality and Improvement sponsored by the American Society for Quality (ASQ). Representatives from 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 Conference 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, 2005 we had improved 69 % of our processes, 159 of the 230 processes identified in our organization.

Efficiency and Quality

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

Process	Initial Value	Value at June 30, 2005
Revision of Audit Reports (Simple Audits)	146 days	11 days
Draft on Audit Reports (Simple Audits)	52 hrs.	13 hrs.
Response to Requests for Contracts (1-5 contracts)	3.7 days	21.6 minutes
Revision of Audit Reports	1.97 errors/report	1.09 errors/report

As shown in this table, the efficiency and quality of the processes depicted continue to be outstanding. These enhancements are 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 two editions of the Quality Newsletter, which informs our personnel of our accomplishments and provides updates on the latest TQM techniques and best practices.

At the request of the Turabo University, the Comptroller represented the public service sector in a panel of the American Society for Quality where he made a presentation about the benefits of adopting and implementing the managerial philosophy of Total Quality in the 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 of 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 comply 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, 2005, the Comptroller’s Office had received 858 and evaluated 816 CAPs to ascertain compliance with the recommendations contained in the audit reports. This figure includes initial CAPs and subsequent progress reports. During fiscal year 2003-04 the Office received 703 and evaluated 602 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 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 their contracts and deeds, including amendments thereto. Additionally, they have to submit a copy of their 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 and deed 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 <http://www.ocpr.gov.pr>. Interested parties may request copies of these contracts. A nominal fee is required for each copy. The Office received 2,371 requests for copies during fiscal year 2004-05.

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 120,614 contracts during fiscal year 2003-2004 and 121,079 in 2004-2005.

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 to collect and store the data reported by government entities in compliance with the provisions of Law No. 96 of June 26, 1964, as amended. As per this statute, government entities are also required to report certain losses to the Treasury Department and the Justice Department.

In compliance with the requirements of Law No. 96, *supra*, during fiscal year 2004-05, our Office received information on 5,268 cases for a loss of \$3,482,676. These cases are subject to further examination when the corresponding government entities are audited.

Registry of Privatization

Law No. 136 of June 7, 2003, requires all government entities, including public corporations and municipalities to submit an annual report of all privatizations of functions, area of administration or duties of their entities to the Governor, Legislature and the Office of the Comptroller. Additionally, they have to submit all documents related to contracts, budget, projects, obligations, internal controls and an independent financial and administrative evaluation of said privatizations. The Office is required to maintain a registry on all reports received. The Registry is accessible to the general public via Internet at <http://www.ocpr.gov.pr>.

Result of Operations

Budget

The original budget assigned to the Office for fiscal year 2004-2005 was \$40,114,000. In December 2004 the Treasury Department of Puerto Rico reimbursed \$973,539 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 \$41,087,539 a 6% increase over the budget assigned for the previous fiscal year. The Office spent and encumbered \$39,831,804, leaving a balance not reserved of \$1,255,735. 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 2004-05, our Office issued 202 reports. These reports involved audits that revealed administrative deficiencies, irregularities or illegal acts in the transactions involving public funds and property. By June 30, 2005, the aforementioned reports had been sent to the Governor, the President of the Senate, and the Speaker of the House of Representatives and published in our website. (Charts 2 and 3)

Human Capital

As of June 30, 2005 the Office had 643 occupied positions, or 98% out of 659 authorized positions. Four hundred twenty-eight, 428 (67%), were auditors and 215 (33%) were support personnel. Support personnel consist of legal counsels, administrative staff, and other professionals (Chart 4). During 2004-2005, 14 auditors and 7 support personnel resigned or retired, while 14 auditors and 15 support personnel were hired. In addition, the Office hired 21 temporary employees 14 of which participated in the Summer Internship



Program. A grand total of 1,164,511 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 2004-05, 47,265 hours were dedicated to training and education. Seminars and conferences in auditing, TQM and recent developments 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 on 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

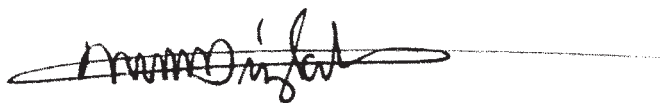
Pannell Kerr Forster, LLP, an independent certified public accounting firm, performed the audit of the financial statements of the Office for the fiscal year ending June 30, 2005. The report of the Independent Auditors is included in the financial section. The accounting firm performed the audit at the time expected and the Office received the certified financial statements on September 15, 2005.

Financial Reporting

The Office complies with financial reporting requirements.

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

Respectfully submitted,



Manuel Díaz Saldaña





Principal Officers

OFFICE OF THE COMPTROLLER

PRINCIPAL OFFICERS AS OF
JUNE 30, 2005

MANUEL DÍAZ SALDAÑA, CPA, CFE
Comptroller

HERIBERTO COLÓN ACEVEDO, CFE
Deputy Comptroller

JAMIEL MIRANDA MATOS,
P.E., ESQ.
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

ELIAZAR E. CRUZ RIVERA, CFE
Special Aide
Peer Review

NATANAEL ARROYO CRUZ, CFE
Special Aide
Audit Affairs

MYRIAM J. FLORES SANTIAGO,
CFE
Internal Audit Director

LISANDRA RIVERA RIVERA,
MAC
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

AURORA BARALT DE JIMÉNEZ, RCM
Director, Human Capital Division

HELVIA MAYORAL AMY
Director, Information Division

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

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

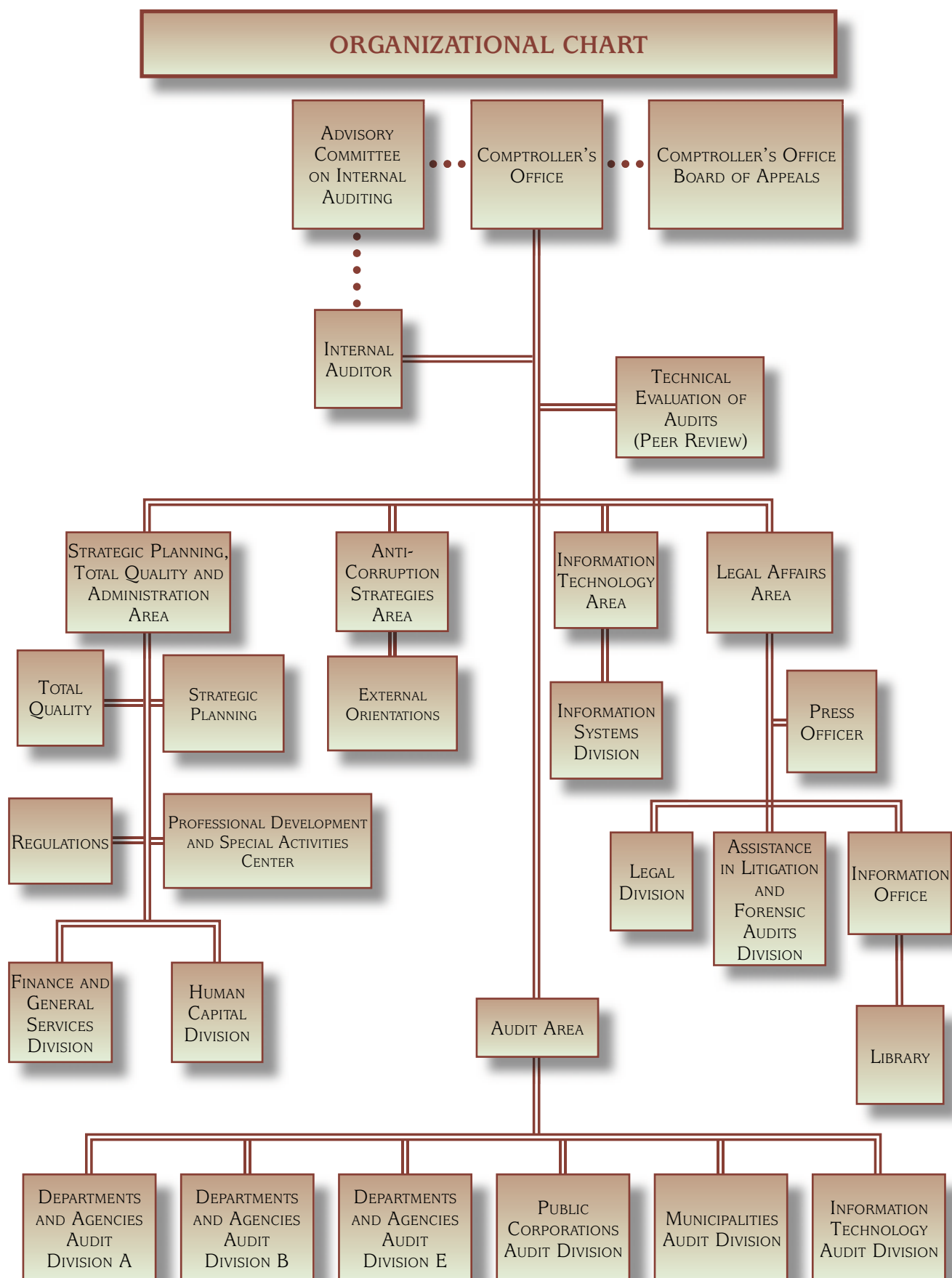
LILLIAN SÁNCHEZ PÉREZ
Director, Professional Development and Special
Activities Center



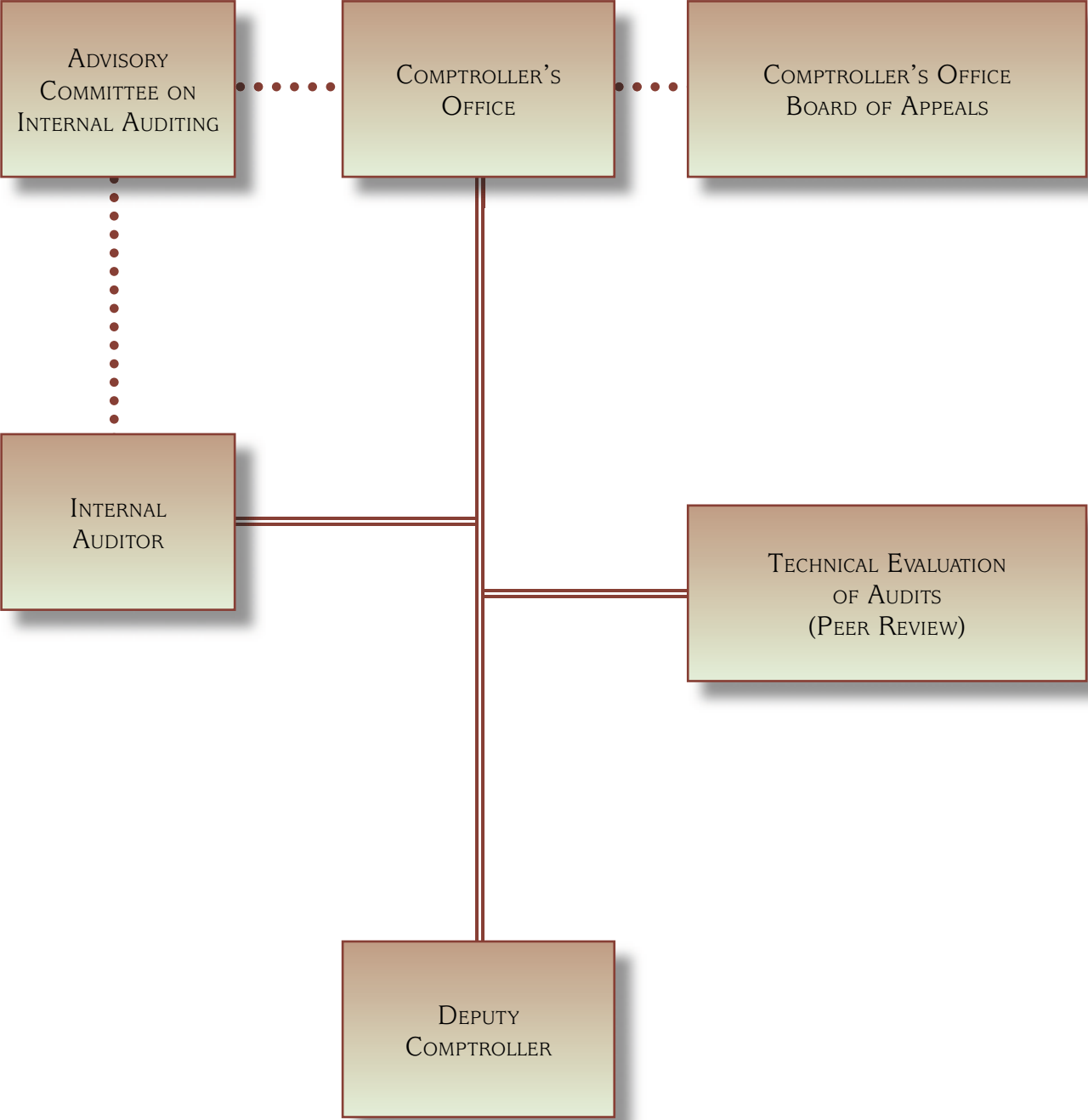


Faro de Cabo Rojo, Cabo Rojo, Puerto Rico

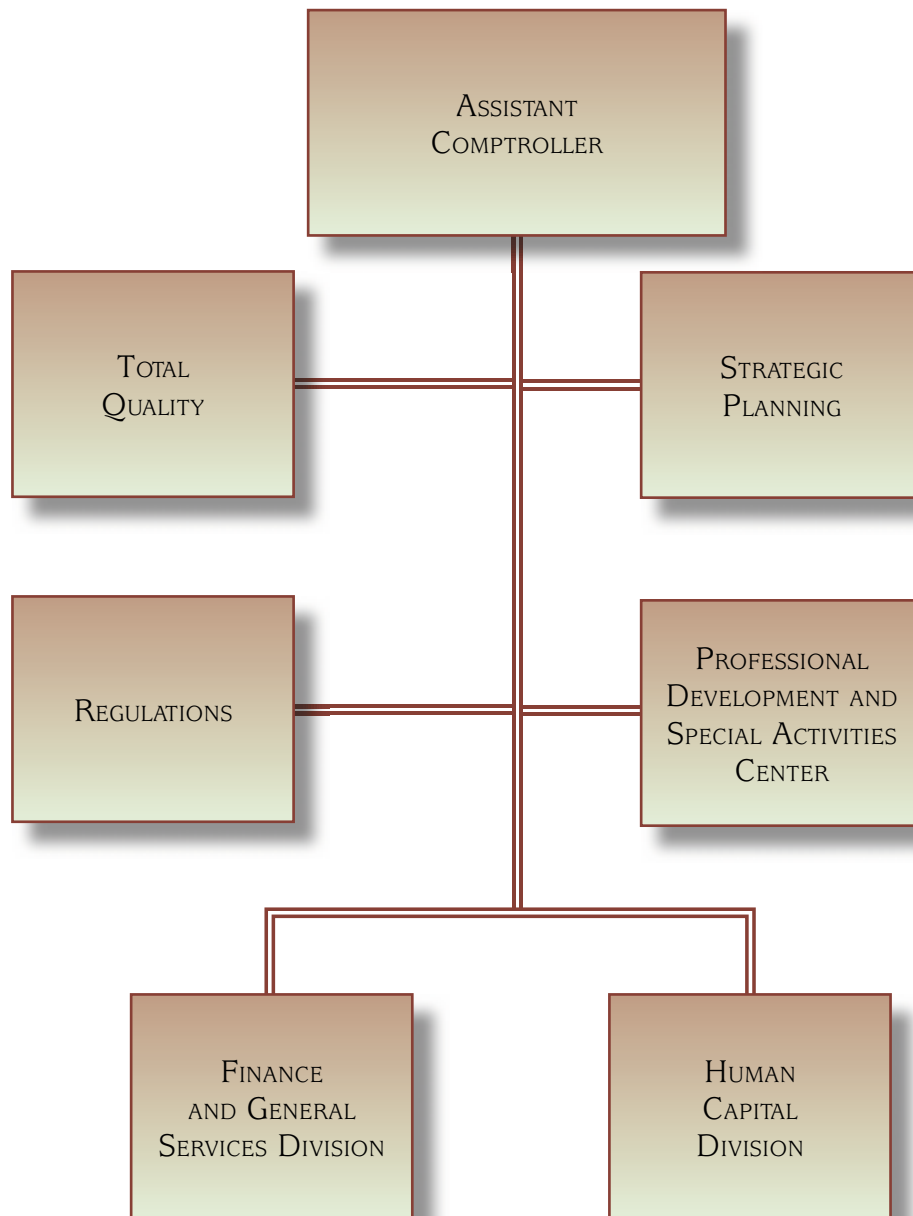
Organizational Charts



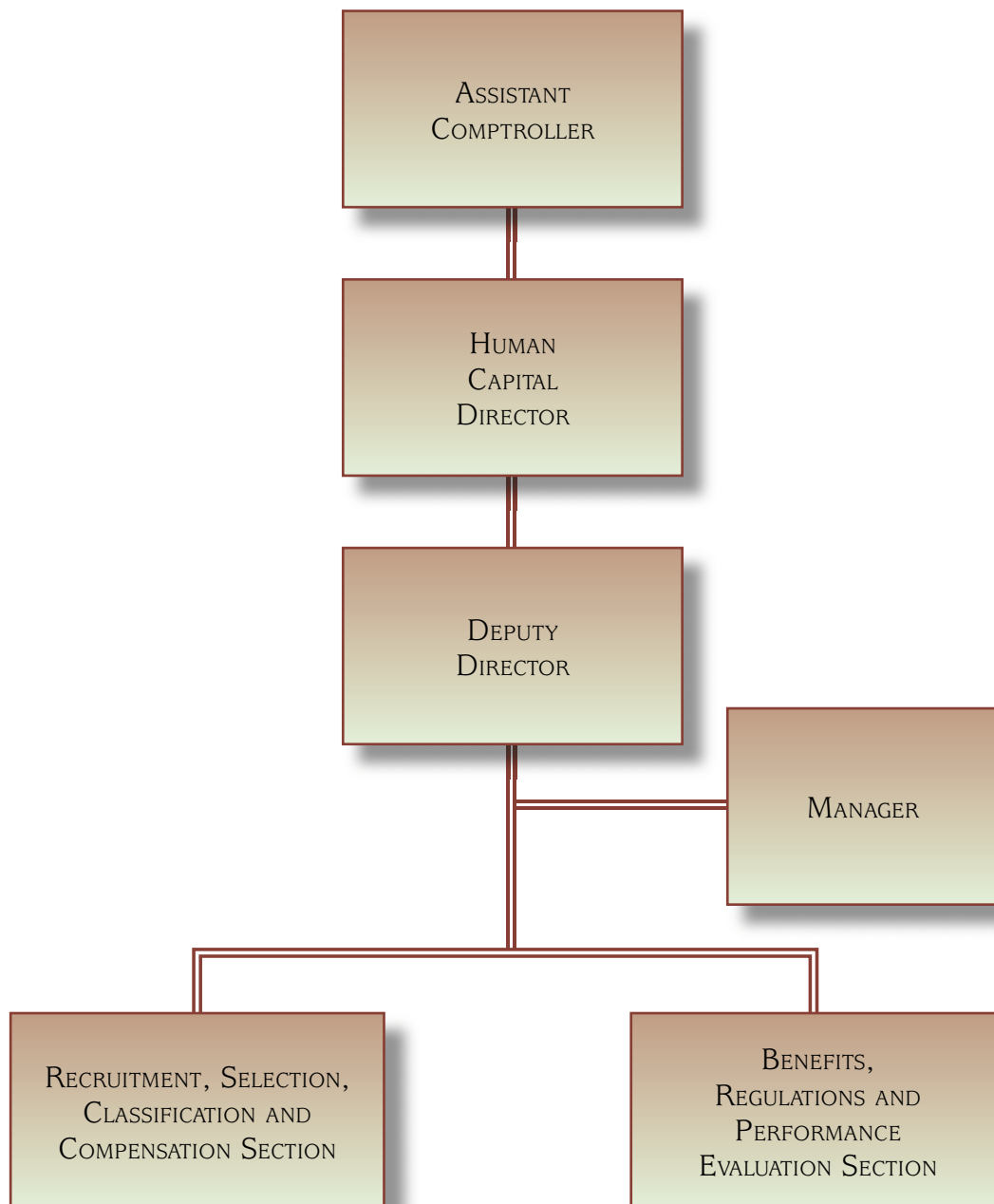
COMPTROLLER'S OFFICE



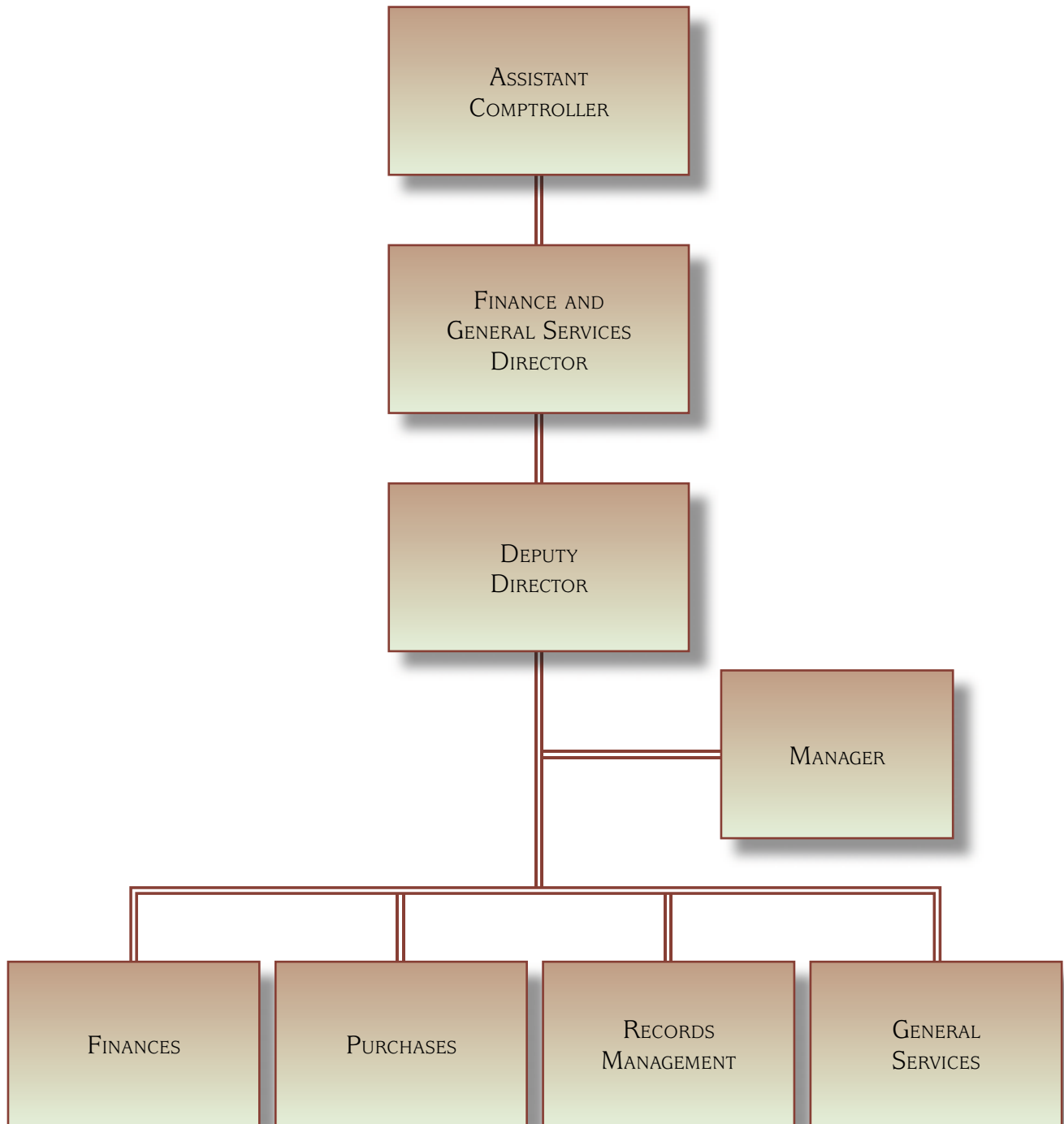
STRATEGIC PLANNING, TOTAL QUALITY AND ADMINISTRATION AREA



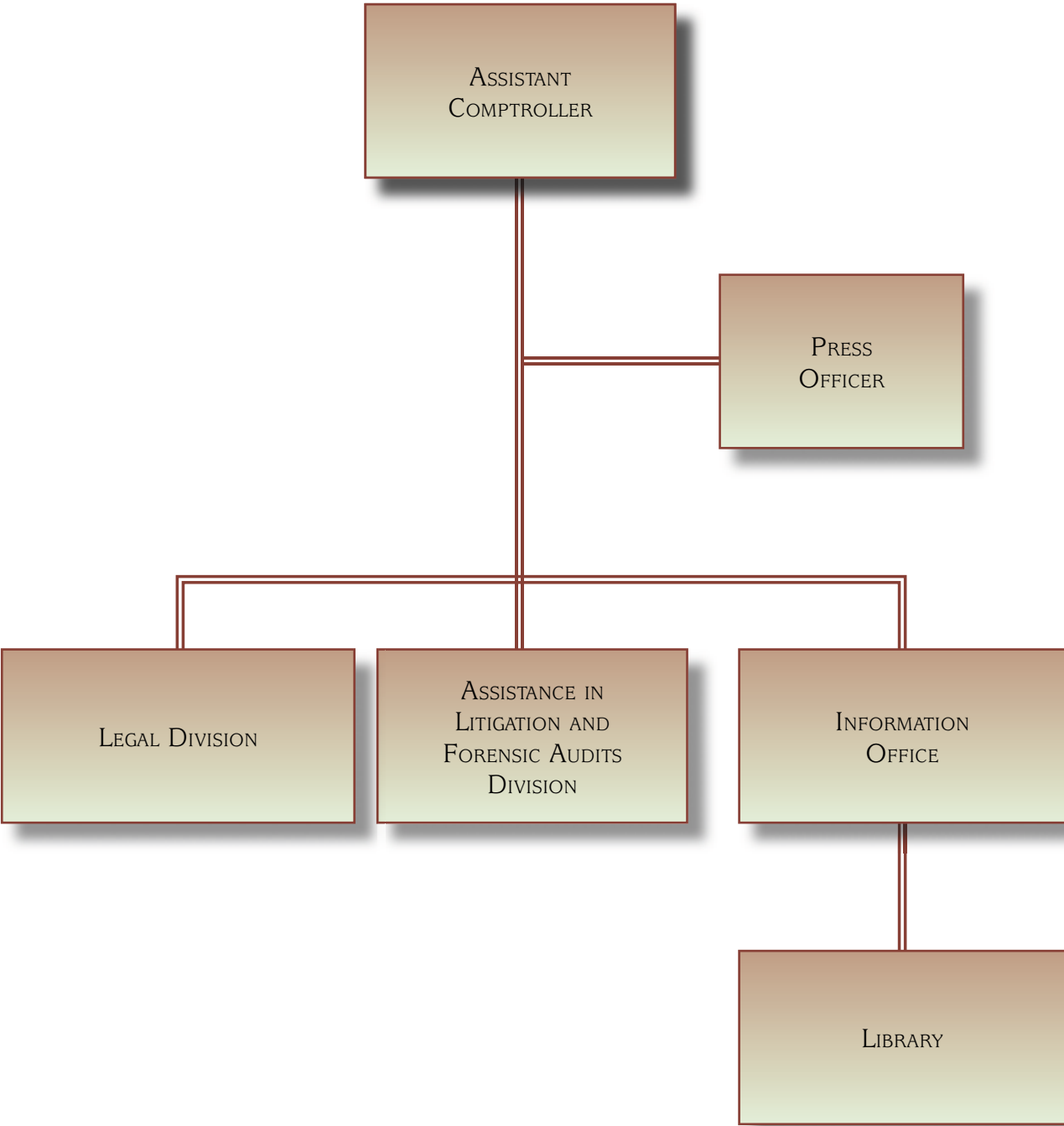
STRATEGIC PLANNING, TOTAL QUALITY
AND ADMINISTRATION AREA
HUMAN CAPITAL DIVISION



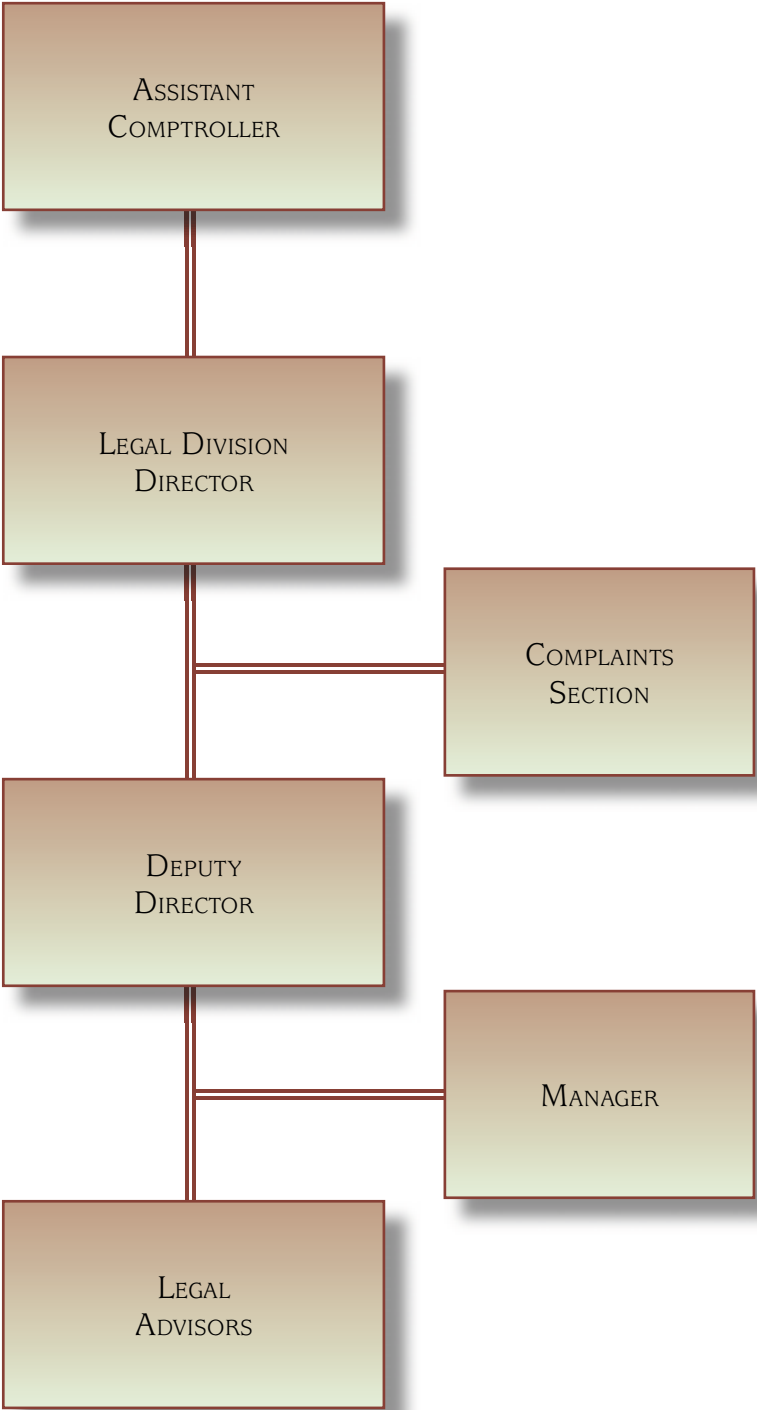
STRATEGIC PLANNING, TOTAL QUALITY
AND ADMINISTRATION AREA
FINANCE AND GENERAL SERVICES DIVISION



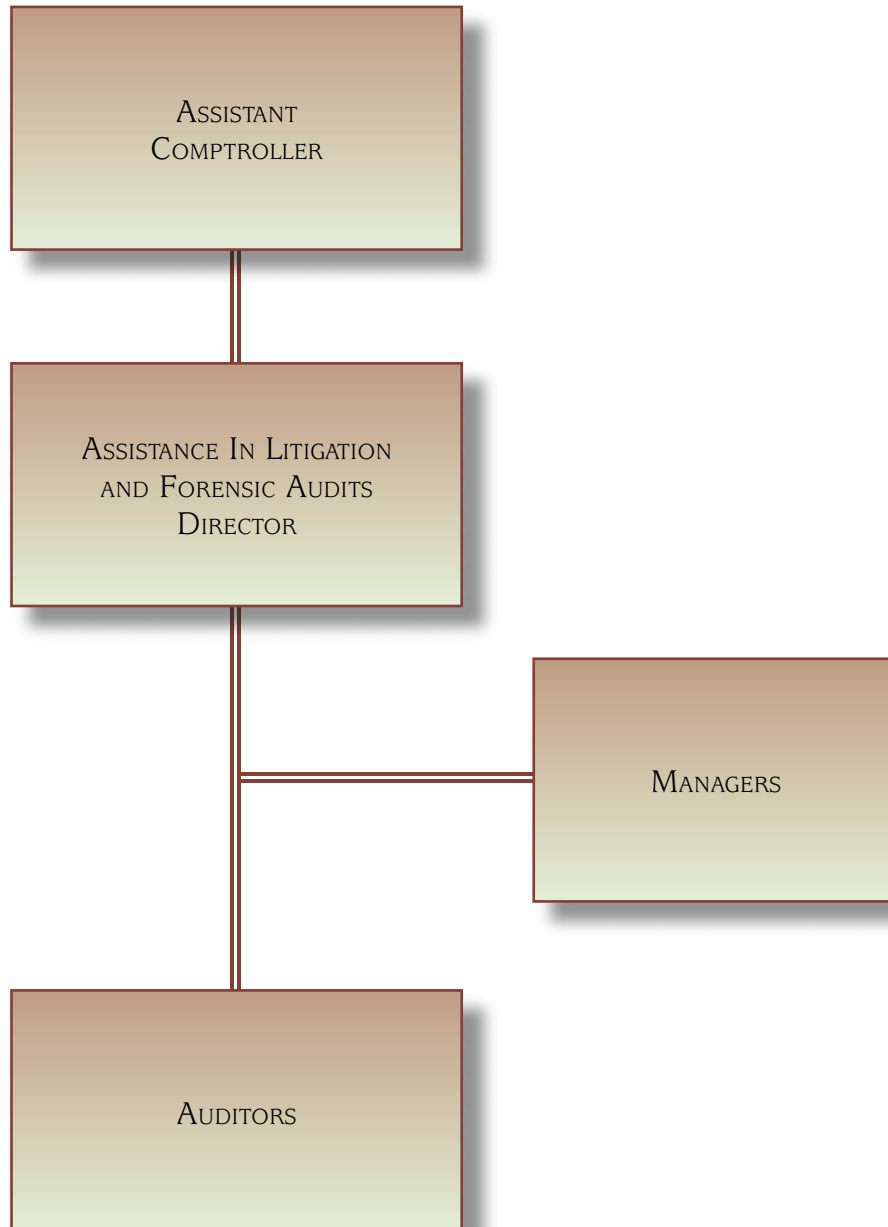
LEGAL AFFAIRS AREA



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
AND MULTIMEDIA
GRAPHIC DESIGNERS

LIBRARY



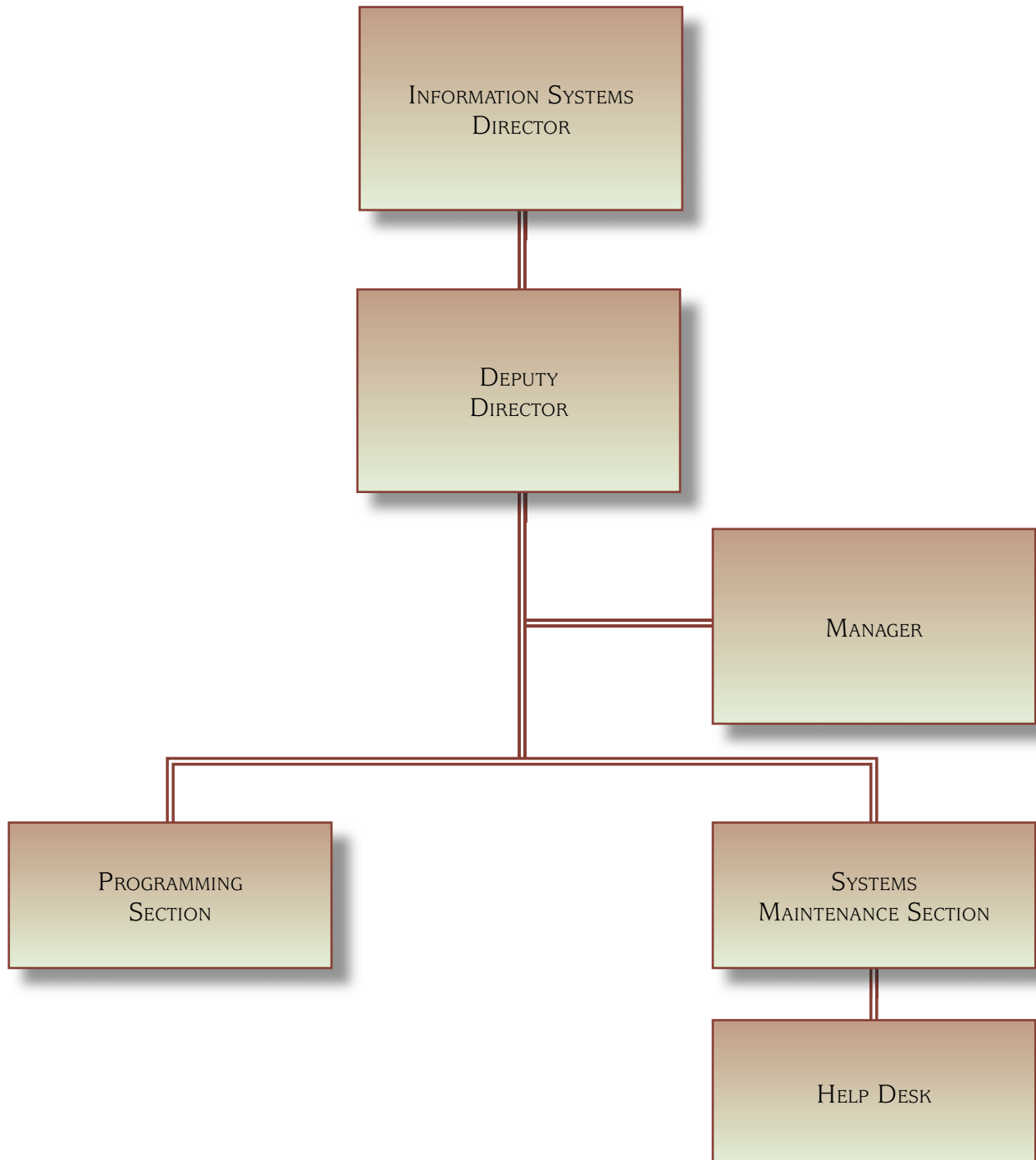
ANTI-CORRUPTION STRATEGIES AREA

ASSISTANT
COMPTROLLER

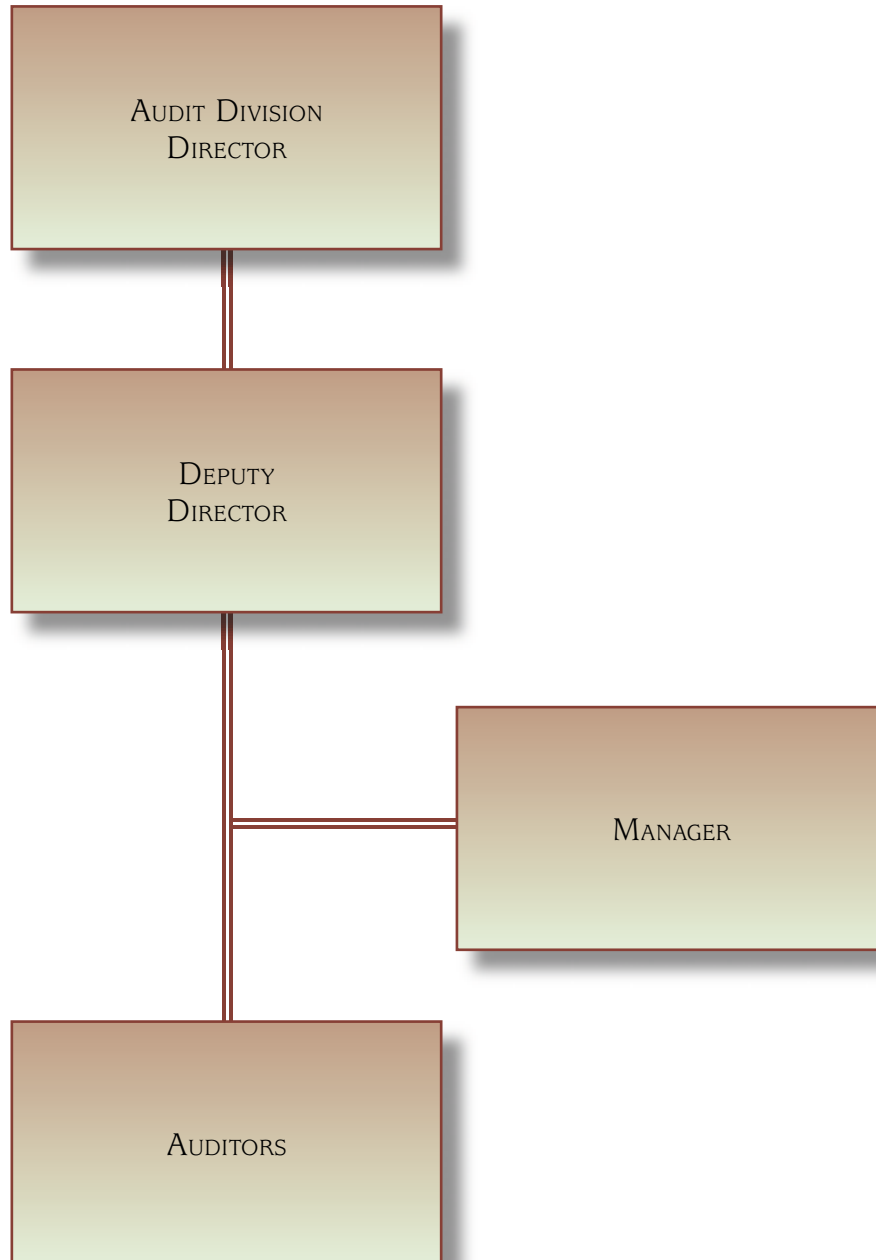
EXTERNAL
ORIENTATIONS



INFORMATION TECHNOLOGY AREA
INFORMATION SYSTEMS DIVISION



AUDIT AREA
AUDIT DIVISIONS



Financial Section





Accountants &
business advisors

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

FINANCIAL STATEMENTS
(With the Independent Auditors' Report Thereon)

**FISCAL YEAR ENDED
JUNE 30, 2005**

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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, 2005, 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 of America. 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 June 30, 2005, and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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PKF, LLP
1056 Muñoz Rivera Avenue, Suite 304
San Juan, PR 00927-5013

The PKF International Association is an association of legally independent firms.

*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 accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued a report dated September 2, 2005, 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 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 our testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.



PKF, LLP

License No. 22
Expires December 1, 2007

September 2, 2005

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

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, 2005.

Financial Highlights

- The total liabilities of the Office of the Comptroller at the close of the fiscal year ended June 30, 2005 amounted to \$12,153,686 comprised of the accrual required under GASB No. 34 for vacations and sick leave in the amount of \$11,401,602 and \$752,084 due to creditors. The liabilities exceeded its assets by \$6,606,691 (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 assets increased by \$109,942. The total amount of this increase is attributable to the fact that the budget approved by the Legislature of the Commonwealth of Puerto Rico for the fiscal year ended June 30, 2005 (\$41,087,539) was approximately six percent (6%) higher than the one approved for the fiscal year ended June 30, 2004 (\$38,611,158).
- The final Budget of the Office of the Comptroller of the Commonwealth of Puerto Rico for the fiscal year 2004-2005 was \$41,087,539. The initial budget of \$40,114,000 increased during the fiscal year by \$973,539. The increase corresponds mainly to the salary increase approved by the Governor of the Commonwealth of Puerto Rico during the fiscal year 2004-2005, to all public employees.

The Office achieved an economy of \$1,255,735 in its management of the general fund budget for the fiscal year 2004-2005.

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 comprise 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.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

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.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

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, 2005, amounts to \$2,087,469. The total invested in the Office of the Comptroller's capital assets for the fiscal year was approximately five (5%) percent of the assigned budget.

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

- The acquisition of several computer equipments for \$857,035.

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.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Management's Discussion and Analysis (continued)

The Office adopted the 2006 fiscal year budget on July 1, 2005. The legislative appropriations for the fiscal year 2006 amount to \$42,000,000.

Requests for Information

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

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Statement of Net Deficit
June 30, 2005

	<u>Governmental Activities</u>
ASSETS	
Current assets:	
Cash held with fiscal agent (note 1)	\$ 3,427,407
Accounts receivable	<u>32,119</u>
Total current assets	3,459,526
Noncurrent assets:	
Capital assets, net (notes 1 and 2)	<u>2,087,469</u>
Total assets	<u>5,546,995</u>
LIABILITIES	
Current liabilities:	
Accounts payable and accrued liabilities	752,084
Accrued compensated absences, current (note 1)	<u>398,521</u>
Total current liabilities	1,150,605
Noncurrent liabilities:	
Accrued compensated absences (note 1)	<u>11,003,081</u>
Total liabilities	<u>12,153,686</u>
NET DEFICIT	
Invested in capital assets (notes 1 and 2)	2,087,469
Deficit	<u>(8,694,160)</u>
Total net deficit	<u>(6,606,691)</u>
Total liabilities and net deficit	<u>\$ 5,546,995</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Statement of Activities
For the Year Ended June 30, 2005

Expenses: (notes 1, 2, 3 and 4)

Salaries and other payroll related costs	\$ 33,896,831
Meals and travel	1,737,535
Professional services	1,460,068
Insurance	57,303
Rent	1,498,219
Utilities	625,491
Depreciation	800,764
Materials and supplies	589,160
Repairs and maintenance	620,143
Trainings and continuing professional education	253,810
Suscriptions and memberships	146,437
Security services	327,223
Printing services	204,676
Postage	60,245
Miscellaneous	177,755
	<u>42,455,660</u>
Revenue (notes 1 and 5)	
State appropriation	<u>41,087,539</u>
Change in net deficit	<u>(1,368,121)</u>
Net deficit at beginning of year (as previously reported)	(5,380,679)
Prior period adjustment	<u>142,109</u>
Net deficit at beginning of year (as restated)	<u>(5,238,570)</u>
Net deficit at end of year	<u>\$ (6,606,691)</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Balance Sheet-Governmental Fund
June 30, 2005

ASSETS

Cash held with fiscal agent (note 1)	\$ 3,427,407
Accounts receivable	<u>32,119</u>
Total assets	<u>3,459,526</u>

LIABILITIES

Accounts payable and accrued liabilities	<u>752,084</u>
--	----------------

FUND BALANCE

Reserved for encumbrances	829,259
Unreserved	<u>1,878,183</u>
Total fund balance (note 1)	<u>2,707,442</u>
Total liabilities and fund balance	<u>\$ 3,459,526</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Reconciliation of the Balance Sheet-Governmental Fund to the Statement of Net Deficit
June 30, 2005

Total fund balance per balance sheet-governmental fund	<u>\$ 2,707,442</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	2,087,469
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>(11,401,602)</u> <u>(9,314,133)</u>
Total net deficit per statement of net deficit	<u>\$ (6,606,691)</u>

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Statement of Revenue, Expenditures and Changes in Fund Balance

Governmental Fund
Year Ended June 30, 2005

Revenue (notes 1 and 5):

State appropriation	\$ 41,087,539
---------------------	---------------

Expenditures (notes 1, 2, 3 and 4):

Salaries and payroll related costs	32,718,185
Meals and travel	1,737,535
Professional services	1,460,068
Insurance	57,303
Rent	1,498,219
Utilities	625,491
Capital outlays	1,129,768
Materials and supplies	589,160
Repairs and maintenance	620,143
Training and continued professional education	253,810
Suscriptions and memberships	146,437
Security services	327,223
Printing services	204,676
Postage	60,245
Miscellaneous	177,755
Total Expenditures	41,606,018

Excess of expenditures over revenues	(518,479)
--------------------------------------	-----------

Fund balance at beginning of year	3,225,921
-----------------------------------	-----------

Fund balance at end of year	\$ 2,707,442
-----------------------------	--------------

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, 2005

Excess of expenditures over revenues	\$ <u>(518,479)</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.	329,004
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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>(1,178,646)</u> <u>(849,642)</u>
--	--

Change in net deficit	\$ <u>(1,368,121)</u>
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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, 2005

	Original Budget	Final Budget	Actual amounts in the budgetary basis	Variance Favorable (Unfavorable)
Revenue:				
State appropriations	\$ 40,114,000	\$ 41,087,539	\$ 41,087,539	\$ -
Expenditures:				
Salaries and payroll related expenditures	29,638,000	32,623,539	32,478,758	144,781
Facilities and payments of public services	372,000	822,000	635,774	186,226
Purchased services	2,241,000	2,091,000	2,081,790	9,210
Awards, subsidies and distributions	45,000	80,000	62,412	17,588
Transportation expenditures	1,945,000	1,470,000	1,443,178	26,822
Profesional services	3,985,000	2,066,000	1,588,616	477,384
Announcements and media publications approved by Law	-	50,000	33,630	16,370
Materials and supplies	-	735,000	458,528	276,472
Capital outlays	1,281,000	-	-	-
Other expenditures	607,000	1,150,000	1,049,118	100,882
	<u>40,114,000</u>	<u>41,087,539</u>	<u>39,831,804</u>	<u>1,255,735</u>
Net Change in fund balance	\$ -	\$ -	\$ 1,255,735	\$ 1,255,735

See notes to financial statements

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements
June 30, 2005

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, the Governor 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, 2005

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, 2005

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 employees 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, 2005

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, 2005 for operational appropriations of \$41,087,539.

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	\$ 39,831,804
Plus prior year encumbrances recorded as expenditures during current year under the GAAP basis	2,159,635
Less current year encumbrances not recorded as expenditures under the modified accrual basis	<u>(385,421)</u>
Expenditures according to the Statement of Governmental Fund Revenue, Expenditures and Changes in Fund Balance	<u>\$ 41,606,018</u>

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2005

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, 2005, are composed of the following:

Fiscal Year	Obligated Funds	Non-Obligated Funds
2001-2002	\$ 252	\$ -
2002-2003	11,169	1,991
2003-2004	432,417	620,457
2004-2005	<u>385,421</u>	<u>1,255,735</u>
	<u>\$ 829,259</u>	<u>\$ 1,878,183</u>

Note 2 - Capital Assets

Capital assets activity for the year ended June 30, 2005 was as follows:

	Beginning Balance (as restated)	Additions	Retirements	Ending Balance
Governmental activities				
Capital assets, being depreciated:				
Equipment	\$ 536,861	\$ 95,254	\$ 2,287	\$ 629,828
Electronic equipment	4,076,469	857,035	896,129	4,037,375
Furniture	1,004,180	85,289	-	1,089,469
Vehicles	<u>264,646</u>	<u>92,190</u>	<u>56,327</u>	<u>300,509</u>
Total capital assets being depreciated	<u>5,882,156</u>	<u>1,129,768</u>	<u>954,743</u>	<u>\$ 6,057,181</u>
Less accumulated depreciation for:				
Equipment	345,499	112,180	2,287	455,392
Electronic equipment	2,921,272	565,932	840,132	2,647,072
Furniture	665,735	97,730	-	763,465
Vehicles	<u>129,389</u>	<u>24,922</u>	<u>50,528</u>	<u>103,783</u>
Total accumulated depreciation	<u>4,061,895</u>	<u>800,764</u>	<u>892,947</u>	<u>3,969,712</u>
Total capital assets, being depreciated, net	<u>\$ 1,820,261</u>	<u>\$ 329,004</u>	<u>\$ 61,796</u>	<u>\$ 2,087,469</u>

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2005

The Office performed the following corrections to the following beginning capital assets balance at July 1, 2004 by decreasing both the historical cost by \$41,100 and accumulated depreciation by \$183,209 as follows:

Cost of capital assets:

Description	Equipment	Electronic Equipment	Furniture	Total
Capital assets not reported in prior years	\$ 205,813	\$ 61,767	\$ -	\$ 267,580
Capital assets retirements not considered in prior years	(27,336)	(230,986)	(4,606)	(262,928)
(Over) understatement of valuation in prior years	<u>3,045</u>	<u>(43,361)</u>	<u>(5,436)</u>	<u>(45,752)</u>
Total corrections	181,522	(212,580)	(10,042)	(41,100)
Balance at June 30, 2004 (as previously reported)	<u>355,339</u>	<u>4,289,049</u>	<u>1,014,222</u>	<u>5,658,610</u>
Balance at June 30, 2004 (as restated)	<u>\$ 536,861</u>	<u>\$ 4,076,469</u>	<u>\$ 1,004,180</u>	<u>\$ 5,617,510</u>

Accumulated depreciation:

Description	Equipment	Electronic Equipment	Furniture	Total
Capital assets not reported in prior years	\$ 89,997	\$ 19,368	\$ -	\$ 109,365
Capital assets retirements not considered in prior years	(18,997)	(228,792)	(1,277)	(249,066)
(Over) understatement of valuation in prior years	<u>2,321</u>	<u>(44,604)</u>	<u>(1,225)</u>	<u>(43,508)</u>
Total	73,321	(254,028)	(2,502)	(183,209)
Balance at June 30, 2004 (as previously reported)	<u>272,178</u>	<u>3,175,300</u>	<u>668,237</u>	<u>4,115,715</u>
Balance at June 30, 2004 (as restated)	<u>\$ 345,499</u>	<u>\$ 2,921,272</u>	<u>\$ 665,735</u>	<u>\$ 3,932,506</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 OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2005

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, 2005 amounted to approximately \$ 2,203,832.

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.

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, 2005, total covered payroll was approximately \$23,761,000. 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, 2005 a copy of which can be obtained from Juan Cancel Alegría, Esq. Administrator of the Retirement Systems of the Commonwealth of Puerto Rico, P.O. Box 42003, San Juan, Puerto Rico 00949.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

Notes to Financial Statements (continued)
June 30, 2005

Note 4 - Lease Commitments

The Office rents its facilities through operating lease agreements in which the latest expires in 2008. Rent expense under such lease agreements for the year ended June 30, 2005 amounted to \$1,498,219. Future minimum lease payments as of June 30 are as follows:

2006	\$ 1,350,341
2007	949,257
2008	<u>504,444</u>
	<u>\$ 2,804,042</u>

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 laws 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.



Accountants &
business advisors

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

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

Fiscal Year Ended
June 30, 2005

INDEPENDENT AUDITORS' REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS 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 financial statements of the Office of the Comptroller of the Commonwealth of Puerto Rico (the Office) as of and for the year ended June 30, 2005 and have issued our report thereon dated September 2, 2005. 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.

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 an opinion 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.

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The PKF International Association is an association of legally independent firms.

PKF, LLP

Accountants &
business advisors

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

A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

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 grant agreements, 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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, the Comptroller and the legislature of the Commonwealth Puerto Rico and is not intended to be and should not be used by anyone other than these specified parties.

*PKF, LLP*

License No. 22
Expires December 1, 2007

September 2, 2005

Statistical Section



Castillo Serrallés, Ponce, Puerto Rico



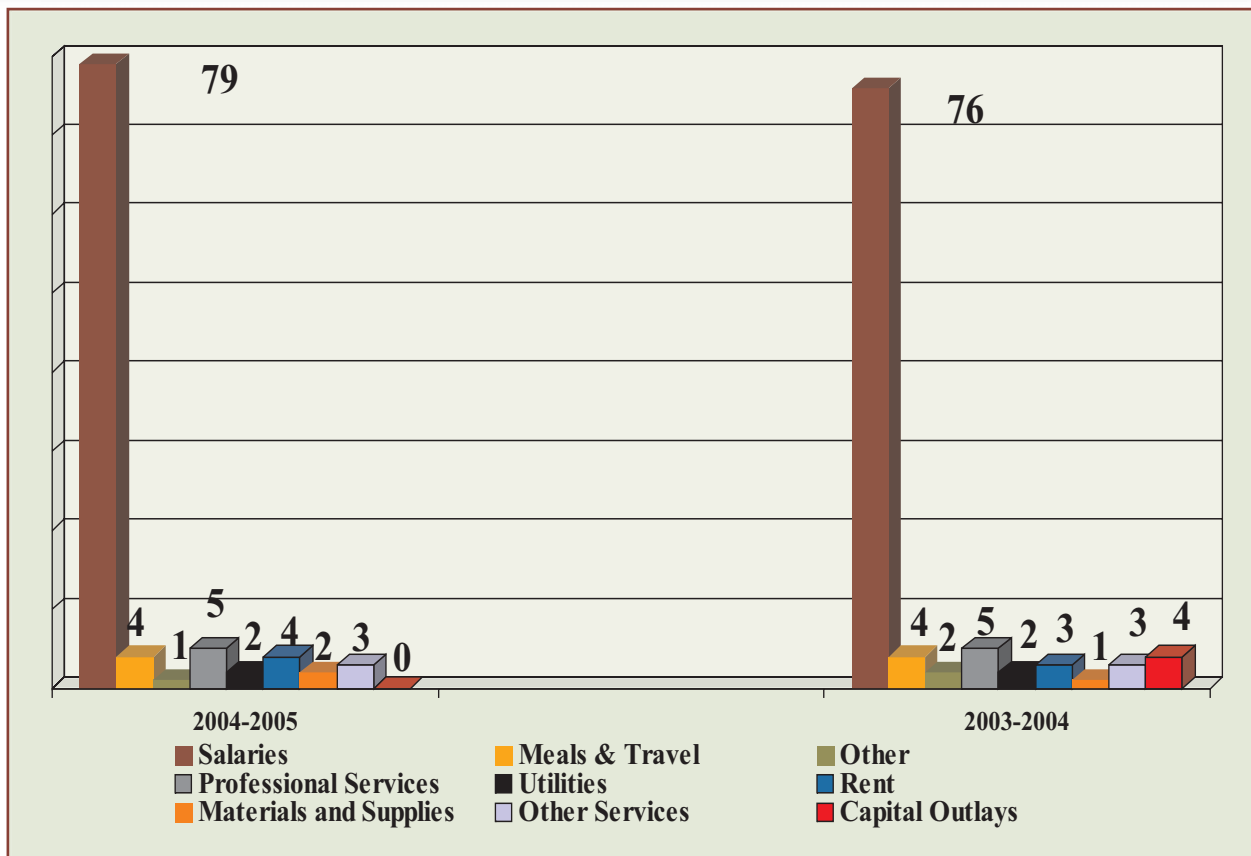
REPORT AND OPERATIONS

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, 2004-05 and 2003-04.

Chart 1 - Budget

Description	2004-05			2003-04	
	Appropriation	Percent		Appropriation	Percent
Salaries & fringe benefits	\$32,623,539	79		\$29,187,819	76
Meals and travel	1,470,000	4		1,498,000	4
Others	592,781	1		1,001,358	2
Professional Services	2,066,000	5		1,897,345	5
Utilities	822,000	2		684,090	2
Rent	1,498,219	4		1,352,691	3
Materials and Supplies	735,000	2		615,000	1
Other Services	1,280,000	3		972,257	3
Capital Outlays	0	0		1,402,598	4
Total	\$41,087,539	100		\$38,611,158	100

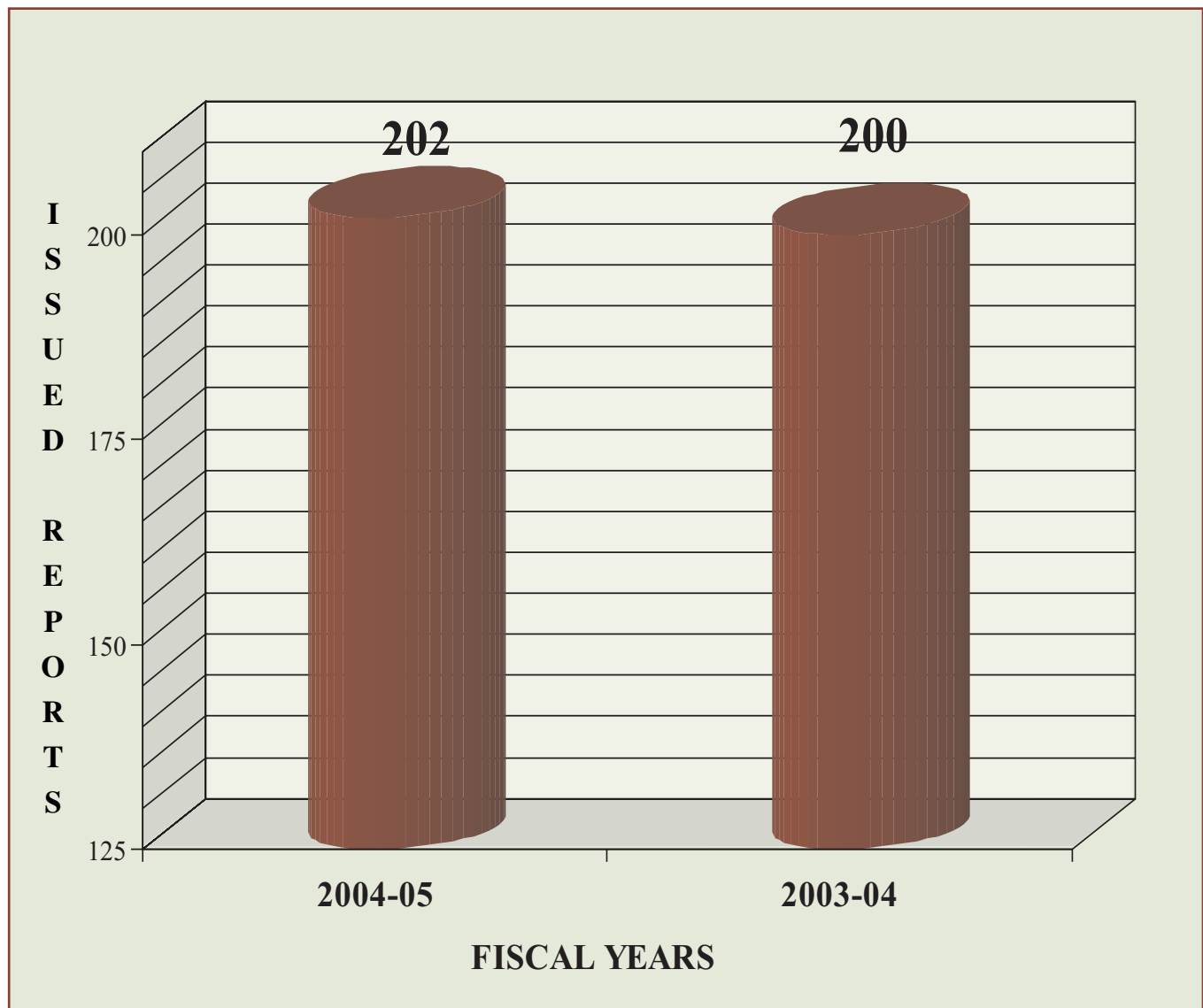


ISSUED REPORTS

During fiscal year 2004-05, our Office issued 202 reports. These reports involved audits which revealed administrative deficiencies, irregularities or illegal acts in the operation of audited units. By the end of each fiscal year, the reports had been sent to the Governor, the President of the Senate and the Speaker of the House of Representatives and published in our website.

Chart 2 shows the number of Issued Reports for fiscal years 2004-05 and 2003-04.

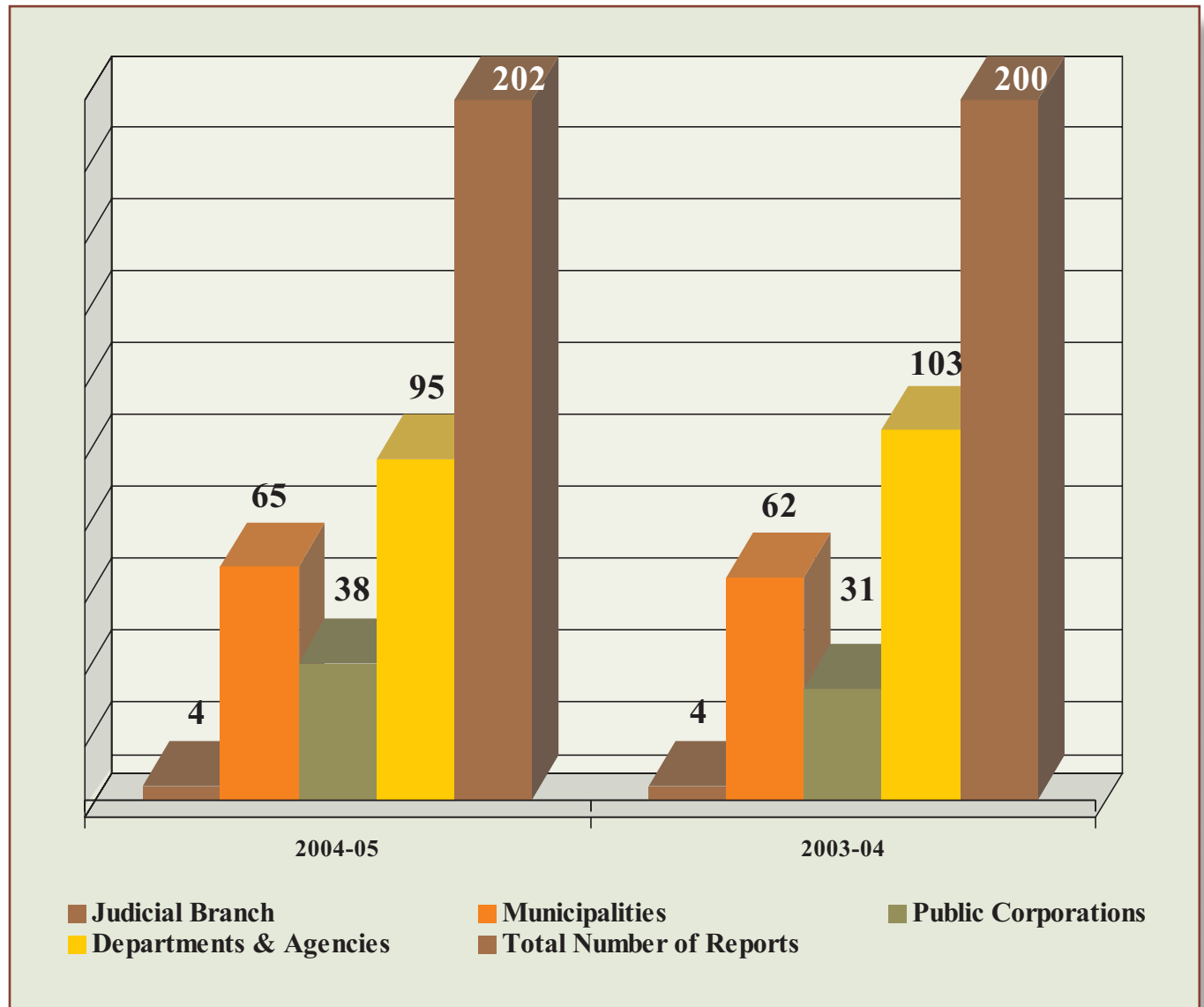
Chart 2 - Issued Reports



ISSUED REPORTS BY TYPE OF GOVERNMENT ENTITY

This chart shows the number of Issued Reports by type of governmental entity for fiscal year 2004-05 and 2003-04.

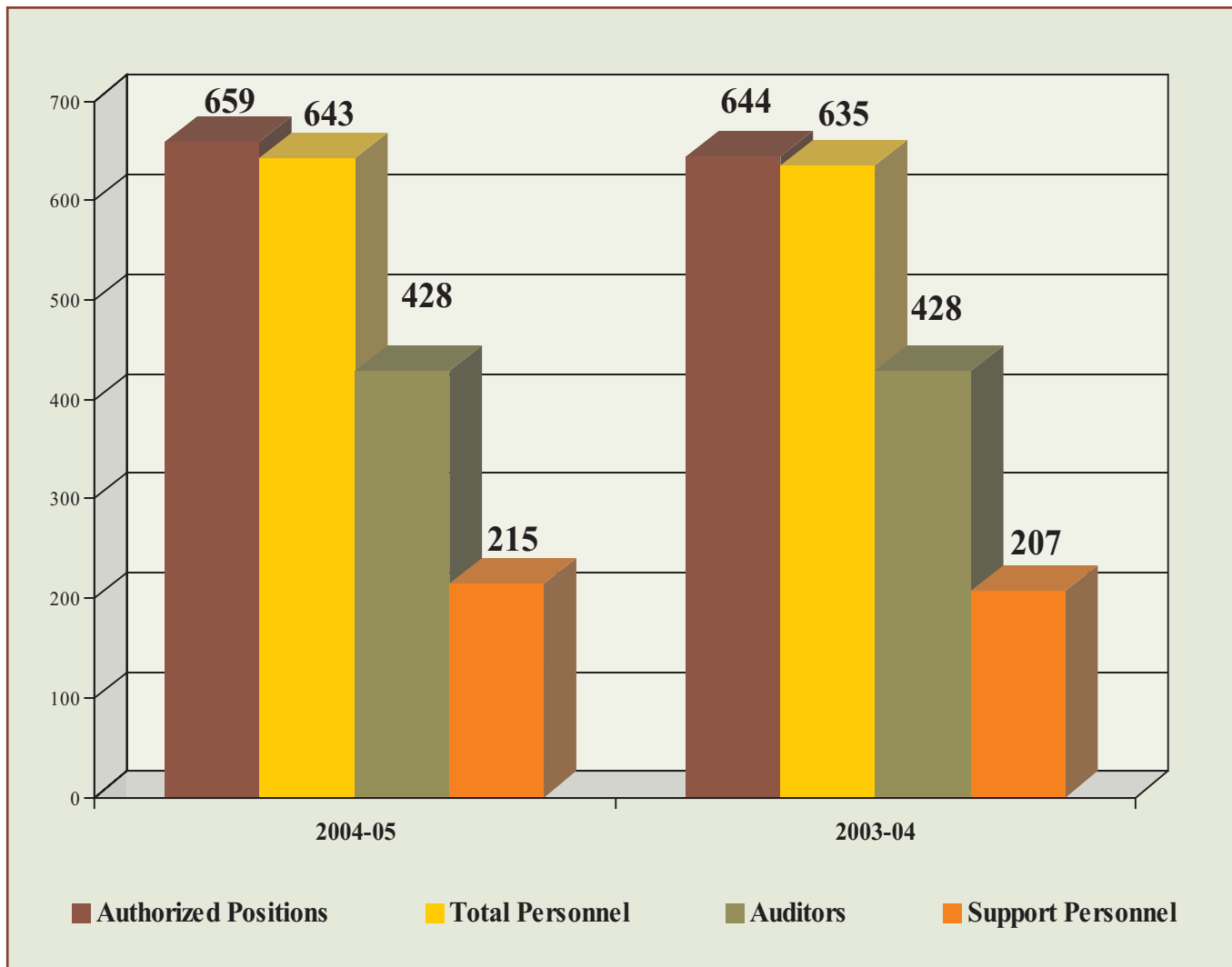
Chart 3 - Issued Reports by Entity



CAPITAL RESOURCES

This Chart shows the breakdown of audit and support personnel for fiscal years 2004-05 and 2003-04.

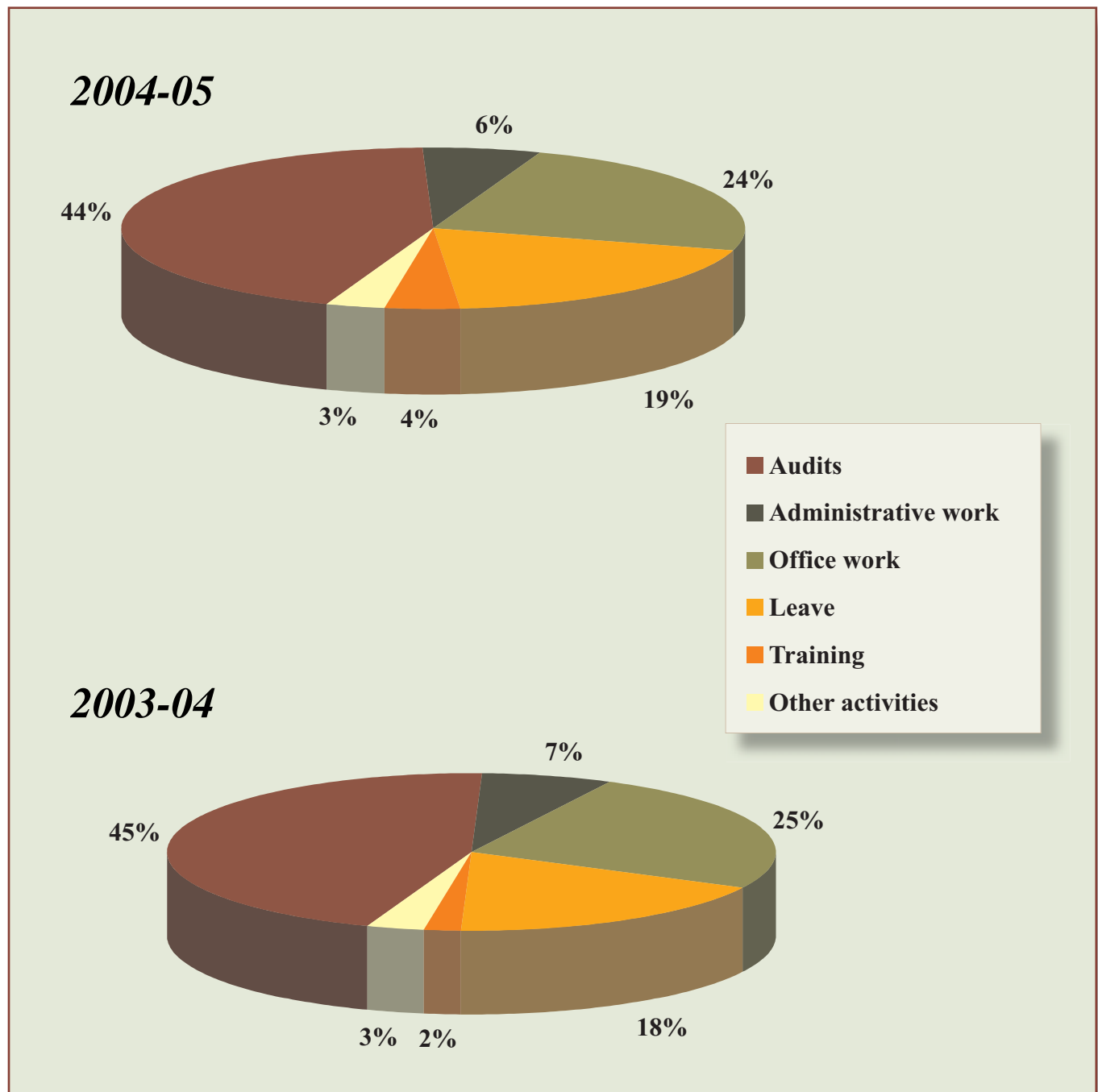
Chart 4 - Distribution of Capital Resources by Auditor and Support Personnel ● ● ● ●



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 2004-05 and 2003-04



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

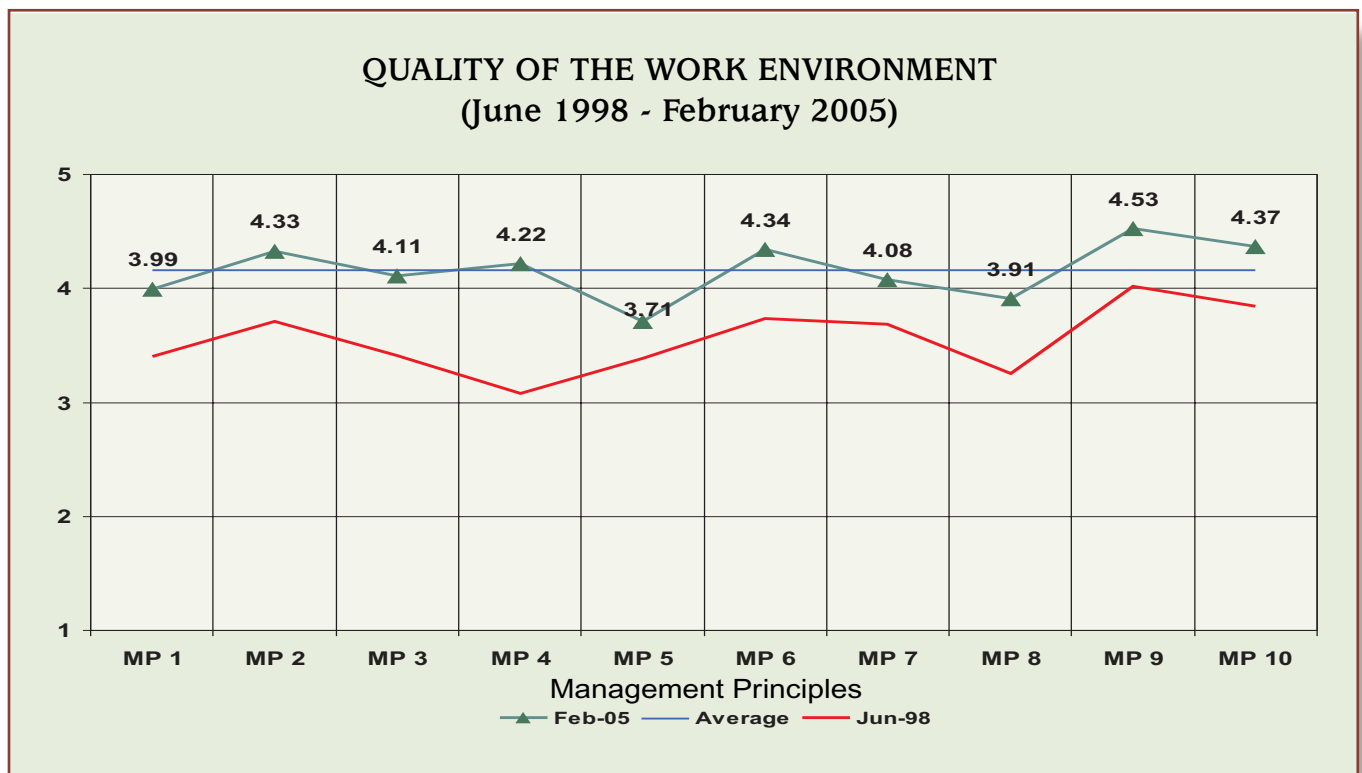
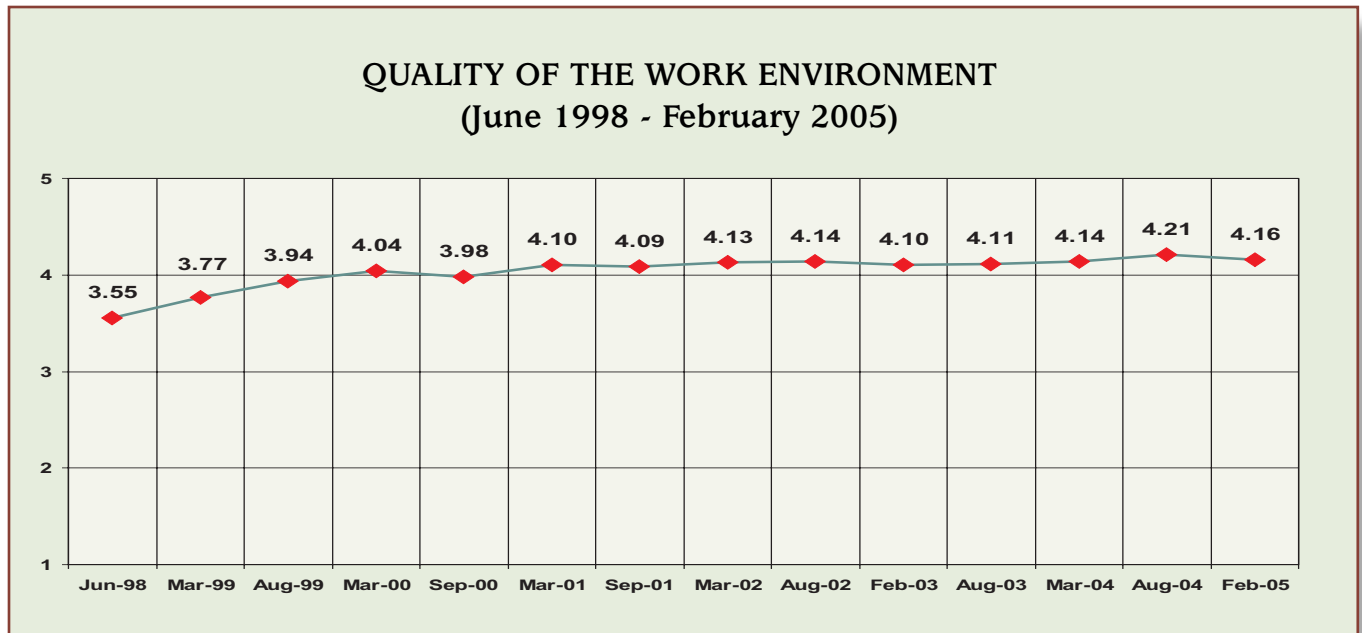
Zero Tolerance to Corruption



REFERENCE GUIDES PUBLISHED



MEASUREMENT OF THE QUALITY OF THE WORK ENVIRONMENT





Ateneo Puertorriqueño,
San Juan, Puerto Rico



Casa de España,
San Juan, Puerto Rico

Government
Reception Center
San Juan, Puerto Rico



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



Plaza de la Rogativa,
San Juan, Puerto Rico

School of Tropical Medicine,
San Juan, Puerto Rico



Casa Olímpica,
San Juan, Puerto Rico



