

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER



COMPREHENSIVE ANNUAL FINANCIAL REPORT

FISCAL YEAR ENDED JUNE 30, 2003



TQM

A Total Quality Management Organization



COMMONWEALTH OF PUERTO RICO

OFFICE OF THE COMPTROLLER

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For fiscal Year Ended June 30, 2003

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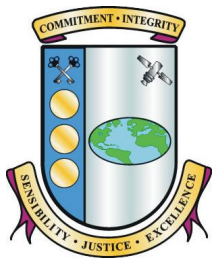


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Commonwealth of Puerto Rico
Office of the Comptroller

Manuel Díaz Saldaña
Comptroller

December 29, 2003

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, 2003. 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.

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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 3,858,800 in 2002. The Puerto Rico Planning Board estimates that as of July 2006, the population will be 3,949,000.

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 2,235 units for auditing or examination purposes. This figure includes departments, agencies, public corporations, municipalities, and 1,532 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 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

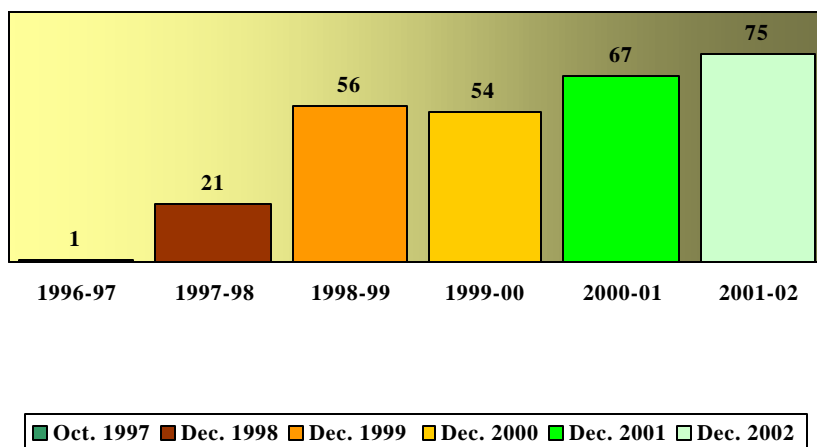
1. Published 186 audit reports during the fiscal year. When compared with the previous fiscal year, this amount represents an increase of approximately four per cent.

Among the most important reports published are:

- a. Audit Reports CP-03-02 of July 22, 2002, CP-04-01 of July 17, 2003, and CP-04-04 of September 23, 2003, regarding the Water & Wastewater Plants of the Puerto Rico Aqueducts and Sewer Authority.
 - b. Audit Report CP-03-17 of February 20, 2003, regarding the First Evaluation of the University of Puerto Rico Campus on Complying with Certain Criteria Established by this Office for Improving Public Administration. Eight campuses that complied with the criteria were given awards. This represents 73 per cent of the 11 campuses evaluated.
 - c. Audit Report DA-03-20 of April 28, 2003, regarding the Second survey of the Internal Audit Activity in the Government of Puerto Rico. Recommendations on improving the performance of the audit offices were presented to the Governor, the President of the Senate and the Speaker of the House of Representatives and the chief executives of the government entities. The survey involved 96 agencies and 42 public corporations.
 - d. Audit Report M-03-04E of April 29, 2003, regarding the Fifth Evaluation of the Municipalities on Complying with Certain Criteria Established by this Office for Improving Public Administration.
 - e. Ten audit reports regarding the Community Schools.
2. Acquired a computer program known as *TEAMMATE* in order to reduce the use of paper in the audits (paper-less) and adapted it to our needs. A group of 10 fellow-workers were designated as *Teammate Champions* to direct its use in the audit divisions. A pilot program will be started during fiscal year 2003-2004 and expanded in subsequent years.
 3. Continue to promote promptness in the preparation of the audited financial statements of the municipalities, as a strategy on prevention. In October 1997, only one municipality had prepared its audited financial statements for Fiscal Year 1996-1997. On December 31, 2002, 75 municipalities (96 per cent) had prepared their financial statements for the Fiscal Year 2001-2002. In July 2003, one hundred per cent of the municipalities submitted their audited financial statements for that period. Statistical data regarding financial statements completed during fiscal years from 1996-1997 to 2001-2002 follows:



MUNICIPALITIES



4. On February 6, 2003 the Comptroller signed a revised Memorandum of Understanding (MOU) with the United States Attorney for the District of Puerto Rico and the Special Agent in Charge of the Federal Bureau of Investigation. The purpose of the MOU is to coordinate the referral of cases arising out of the audits conducted by this Office.

Education and Orientation

1. Offered lectures to 52 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 69 lectures to 4,186 government officials and employees, and members of non-profit organizations, as part of our on-going campaign on **Cero Tolerance to Corruption**.
3. Collaborated with the Courts Administration by training the judges of the Courts of First Instance on the audit processes and the investigation of white-collar crimes. The Office of Government Ethics, the Special Independent Prosecutor's Panel, and the Department of Justice, participated in this training also.

Strategies Developed for Proper Administration

1. As part of our **Prevention Program** we endorsed the approval of Law No. 1 of January 1, 2003, that created the Civil Suits Registry of the Commonwealth of Puerto Rico to be administrated by the Department of Justice.
2. Participated in meetings with professional organizations associated with our oversight function and our vision of prevention. Among others, the Annual Conference of the National Association of State Auditors, Comptrollers and Treasurers in Oklahoma; and the Annual Meeting of the Organization of Latin American and Caribbean Supreme Audit Institutions held in Mexico.
3. Offered a training course to various members of the government of the Dominican Republic on auditing related matters.



Customer Services

1. On December 30, 2002, we published the comptrollership's annual report. This is known as the **Comprehensive Annual Financial Report (CAFR)**, which contains a summary of the goals achieved during the year, the financial statements audited by our external auditors and statistical information regarding the operations of the Office during that period. It also includes a report on **Relevant Data Regarding the Audit Reports Published during the Fiscal Year and a Summary of the Primary Findings as of June 30, 2002.**
2. 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 19 processes.
 - b. Completed three additional rounds of Process Improvement Teams and completed the analysis of 132 processes. This represents 58 per cent of the 228 processes identified in the Office.
 - c. Administered two Workplace Environmental Quality Surveys in order to obtain our fellow-workers perception on the application of the Ten Management Practices adopted. The result of the surveys tabulated up to February 2003 was 4.10 on a scale of five points, which reflects an increase of .55 points or an increase of 13 per cent on the index, compared with the first survey which was taken in June 1998 (3.55).
3. A Code of Ethics regulating the conduct and responsibilities of contractors and suppliers of goods and services of the Office was established, by means of Supplement No. 1 to **Regulation No. 31**, approved on October 14, 2002.

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** was established to help fellow-workers maintain good physical condition. Lectures are offered to interested fellow-workers and their immediate families, in a program known as **Strengthening the Family.**
4. As part of our commitment to the community, we engaged in special activities. Among them: two blood donation campaigns, collecting toys for economic disadvantage children from Barrio Obrero in Santurce, and used clothing donated to the Salvation Army.



Technology

1. An electronic system was designed to increase the efficiency of the government agencies in complying with Law No. 96 of June 26, 1964, which requires them to notify the loss of public property and funds to the Comptroller. This was done as part of our paper-less policy. Shortly we will train the agencies on this new system for which a **User's Manual** was written.
2. The infrastructure for automatic security against codes and harmful programs was developed.
3. A procedure for controlling computer program licenses was developed.
4. Various procedures related to information systems were developed and documented.
5. A Disaster Recovery Plan (DRP) for recovering the information systems in case of disasters was developed.

Communication

1. Published a brochure called: **The Controllorship...An Alternative for your Future.**
2. Daily maintenance of our web and intranet pages and providing the necessary information enabling our fellow-workers to do their work more efficiently. This will also permit our customers to keep up to date with the audit reports published and the regulations in force, among other things.
3. Continued with our program of **Controllorship within Your Reach** by visiting Shopping Malls in Aguadilla and Mayaguez. During these visits we offer information to the citizens on the role of the Office and receive information on allegations of wrongful use of public property and funds.

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 25 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. It was taken by 262 fellow-workers.
3. **How to Encourage Responsibility Seminar** aimed at maintaining the excellence of our human resources, according to our Vision of Excellence. Two hundred forty seven (247) persons were trained.
4. **Six Sigma Seminar** to improve the skills of our Process Improvement Team coordinators. It was given to 60 employees. Forty nine percent (296) of all the members of our Office have participated, at least once, in Process Improvement Teams.

External Seminars

In order to keep abreast on the best practices in international quality management issues, five staff members participated in the 57th Annual Congress on Quality sponsored by the American Society for Quality (ASQ). It took place from May 19th to 21st in Kansas City Convention Center, Kansas City, Missouri. 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.

Furthermore, three fellow-workers participated in a Seminar on the ISO 9000 –2000 Norm sponsored by the Comptroller General's Office of the Republic of Bolivia regarding their certification. This seminar took place from July 29th to August 2nd in their offices in La Paz, Bolivia. It included the participation of ten Spanish-speaking countries. The seminar was very useful in helping us achieve our goal of being certified as a world-class organization and to perpetuate our contribution to excellence.

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, 2003, we had improved 58% of our processes, 132 of the 228 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, 2003
Revision of Audit Reports (Simple Audits)	146 days	14.7 days
Supervision of Audits (Complex Audits)	642 days	286.8 days
Requests of contracts (1-5 contracts)	3.7 days	19.3 minutes
Requests of Contracts (6 or more)	6.7 days	124.8 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.

Outreach Program

On August 28, 2002, we held the First Total Quality Conference with the participation of 460 government officials of the Commonwealth of Puerto Rico. The event was coordinated with the objective of promoting a cultural change in Government by means of teamwork and continuous improvement. The principal theme of this activity was: **Total Quality: A Route to Excellence**. We had several presentations including ours, regarding different experiences in adopting the managerial philosophy of Total Quality as a vehicle for continuous improvement. The presentations were primarily given by outstanding and successful businessmen from the private sector.

In the First Total Quality Conference we also had, a panel of professionals, who talked about: **Total Quality and its Contribution in the World of Competitiveness**. Participants were encouraged to assume a historic role in this knowledge era and to adopt the best practices presented in order to be incorporated into the globalize world. The private industry is willing and doing its part, what we have left is a challenge in the hands of the chief government executives to assume their role and perform the changes that are required in order to provide excellent services to the people of Puerto Rico.

On September 25, 2002, the Comptroller gave a speech at the Pontifical Catholic University of Puerto Rico on Strategic Planning to a group of students of the Doctoral Program in Business Administration. It gave us the opportunity to share our experiences



At the request of the Puerto Rico Highways and Transportation Authority, we gave a speech to their executives on October 23, 2002. It dealt with the benefits of adopting and implementing the managerial philosophy of Total Quality in the Comptrollers' Office and the results obtained. Likewise, at the request of the President of Central University of Bayamón we gave a speech on the same topic to their executives on March 30, 2003.

Alliance with our Suppliers

In our desire to strengthen the commercial relations and as part of our continuous improvement process, we had a meeting with our suppliers on December 3, 2002. In that meeting they were informed of our expectations regarding their services and of the managerial philosophy of Total Quality that we practice. Everything within the framework of relevant laws and regulations in effect. This is the second time that we have met with our suppliers in order to ascertain that there is good communication between them and the Comptrollers' Office, with the ultimate goal of daily improvement in our services.

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, 2003, the Comptroller's Office had received and evaluated 735 CAPs to ascertain compliance with the recommendations contained in the audit reports. This figure includes initial CAPs and subsequent progress reports. During fiscal year 2001-02 the Office received and evaluated 730 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 public via Internet. Interested parties may request copies of these contracts. A nominal fee is required for each copy. The Office received 2,291 requests for copies during fiscal year 2002-03.

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 102,910 contracts during fiscal years 2001-02 and 107,669 in 2002-03.

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 2002-03, our Office received information on 2,357 cases totaling \$9,590,235. 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 2002-03 was \$34,081,000. On March 30, 2003 the Treasury Department of Puerto Rico reimbursed \$982,490 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 \$35,063,490, a 2.88% increase over the budget assigned for the previous fiscal year. The Office spent and encumbered \$34,456,487, leaving a balance not reserved of \$607,003. 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 2002-03, our Office issued 186 reports. These reports involved audits that revealed administrative deficiencies, irregularities or illegal acts in the transactions involving public funds and property. By June 30, 2003, 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)

Eighty-two percent (82%) of the reports (153) were issued during fiscal year 2002-03; less than a year after the fieldwork was concluded. The remaining eighteen percent (18%) of the reports (33) took more than a year after completion of the fieldwork.

Human Resources

As of June 30, 2003 the Office had 607 occupied positions, or 96% out of 631 authorized positions. Four hundred twenty-seven 427 (68%) were auditors and 204 (32%) were support personnel. Support personnel consists of legal counsels, administrative staff, and other professionals. (Chart 4) During 2002-03, 9 auditors and 13 support employees resigned or retired, while 2 auditors and 34 support personnel were hired. In addition, the Office hired 68 temporary employees 51 of which participated in the Summer Internship Program. A grand total of 1,161,671 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 2002-03, 49,197 hours were dedicated to training and education. Seminars and Conferences in Auditing, TQM and recent development in Information Technology have been a priority. The Office continues to train its personnel in detecting and preventing corruption. In accordance, we offered a four day training with the participation of the Association of Certified Fraud Examiners as instructors.



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. Ernst & Young LLP, an independent accounting firm, performed the audit for the fiscal year ending June 30, 2003. The report of the Independent Auditors on the financial statements of the Office is included in the financial section.

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



Report of Independent Auditors

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

We have audited the accompanying financial statements of the governmental activities and general fund of the Office of the Comptroller of Puerto Rico (the Office), an agency assigned to the Legislative Branch of the Commonwealth of Puerto Rico, as of June 30, 2003, which collectively comprise the Office basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Office's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States 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 opinions.

As discussed in Note 1, the accompanying financial statements present only the Office of the Comptroller of Puerto Rico 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the general fund of the Office of the Comptroller of Puerto Rico as of June 30, 2003, and the respective changes in financial position thereof and the budgetary comparison for the general fund for the year then ended, in conformity with accounting principles generally accepted in the United States.

The Management's Discussion and Analysis on pages 3 through 5, 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. 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 November 20, 2003, on our consideration of the Office of the Comptroller's internal control over financial reporting and our tests of its compliance with certain provisions 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.

Ernst & Young LLP

November 20, 2003

Stamp No. 1921069
affixed to
original of
this report.



Office of the Comptroller of Puerto Rico

Management's Discussion and Analysis

The Office of the Comptroller of Puerto Rico, an agency 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 of the Comptroller for the fiscal year ended June 30, 2003.

Financial Highlights

- The total liabilities of the Office of the Comptroller at the close of the fiscal year ended June 30, 2003 amounted to \$9,444,457 comprised of the accrual required under GASB No. 34 for vacations and sick leave in the amount of \$8,740,727 and \$703,730 due to creditors. The liabilities exceeded its assets by \$5,261,500 (*net deficiency in assets*) 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 net change in assets decreased by \$3,672,871. The total amount of this decrease is attributable to depreciation expense reported for the fiscal year ended June 30, 2003.
- The final Budget of the Office of the Comptroller of Puerto Rico for the fiscal year 2002-2003 is \$35,063,490. The initial budget of \$34,081,000 increased during the fiscal year by \$982,490. The increase corresponds to the sum of the amounts reimbursed by the Treasury Department for the previous year Christmas Bonus (\$82,861), and the granted increase in the salaries of the public employees, according to Law No. 96 of July 1, 2002 (\$899,629).

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.

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 *Governmental Fund Balance Sheet/Statement of Net Deficiency in assets* 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 deficiency in assets)*. Over time, increases or decreases in net 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.

Office of the Comptroller of Puerto Rico
Management's Discussion and Analysis (continued)

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 (*government activities*). 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, 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 6 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. All of the funds of the Office of the Comptroller belong to categories of Governmental Funds.

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.

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 Funds Balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The Office of the Comptroller maintains one individual governmental fund. We adopt 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.

Office of the Comptroller of Puerto Rico
Management's Discussion and Analysis (continued)

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 9 to 16 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.

Governmental Funds

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, 2003, amounts to \$1,215,484. The total invested in the Office of the Comptroller's capital assets for the fiscal year was three percent of the assigned budget.

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

- The acquisition of several computer equipments for \$484,955.

Economic Factors and Next Year's Budget

The economy of Puerto Rico must be analyzed as a region within the U.S. economy, since it is part of the U.S. 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 U.S. economy.

The Office adopted the 2004 fiscal year Budget on July 1, 2003. The legislative appropriations for fiscal year 2004 amount to approximately \$37,161,000.

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. Questions 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.

Office of the Comptroller of Puerto Rico
Governmental Fund Balance Sheet/Statement of Net Deficiency in Assets
June 30, 2003

	General Fund	Adjustments (Note 2)	Statement of Net Deficiency in Assets
Assets			
Current assets:			
Cash and cash equivalents	\$2,112,370	\$ -	\$ 2,112,370
Noncurrent assets:			
Capital assets, net of accumulated depreciation	-	2,070,587	2,070,587
Total assets	<u>\$2,112,370</u>	<u>\$ 2,070,587</u>	<u>\$ 4,182,957</u>
Liabilities			
Current liabilities:			
Accounts payable and other current liabilities	\$ 703,730	\$ -	\$ 703,730
Accrued vacations and sick leave	-	699,677	699,677
Total current liabilities	<u>703,730</u>	<u>699,677</u>	<u>1,403,407</u>
Accrued vacations and sick leave	-	8,041,050	8,041,050
Total liabilities	<u>703,730</u>	<u>8,740,727</u>	<u>9,444,457</u>
Fund balance/Net deficiency in assets			
Fund balance:			
Reserved for encumbrances	741,915	(741,915)	-
Unreserved	666,725	(666,725)	-
Total fund balance	<u>1,408,640</u>	<u>(1,408,640)</u>	<u>-</u>
Total liabilities and fund balance	<u>\$2,112,370</u>		
Net deficiency in assets:			
Invested in capital assets, net of accumulated depreciation		2,070,587	2,070,587
Deficit		(7,332,087)	(7,332,087)
Total net deficiency in assets		<u>(5,261,500)</u>	<u>(5,261,500)</u>
Total liabilities and net deficiency in assets		<u>\$ 2,070,587</u>	<u>\$ 4,182,957</u>

See accompanying notes.

Office of the Comptroller of Puerto Rico
Statement of Governmental Fund Revenues,
Expenditures, and Changes in Fund Balance/Statement of Activities
Year ended June 30, 2003

	General Fund	Adjustments (Note 2)	Statement of Activities
Revenues			
Legislative appropriations	\$35,063,490	\$ -	\$35,063,490
Expenditures			
Salaries and payroll related expenditures	27,981,550	3,427,836	31,409,386
Professional services	1,222,028	-	1,222,028
Other services	961,216	-	961,216
Meals and travel	1,458,863	-	1,458,863
Rent	1,229,598	-	1,229,598
Utilities	522,940	-	522,940
Materials and supplies	1,801,266	(1,181,783)	619,483
Other	432,692	-	432,692
Depreciation expense	-	880,155	880,155
Total expenditures	35,610,153	3,126,208	38,736,361
Net change in fund balance/net change in assets	(546,663)	(3,126,208)	(3,672,871)
Fund balance/net deficiency in assets			
Beginning of year	1,955,303	(3,543,932)	(1,588,629)
End of year	\$ 1,408,640	\$(6,670,140)	\$ (5,261,500)

See accompanying notes.

Office of the Comptroller of Puerto Rico

Notes to Financial Statements

June 30, 2003

1. Organization and Summary of Significant Accounting Policies

Organization

The position of Comptroller of Puerto Rico was created by the Constitution of the Commonwealth of Puerto Rico. The Office of the Comptroller of Puerto Rico (the Office) was created by Law 9 of 1952. This Office is directed by a Comptroller, who is named for a term of ten years. The function of the Comptroller is to audit all the revenues, accounts and expenditures of the Commonwealth of Puerto Rico (the Commonwealth), its agencies and instrumentalities, and its municipalities, in order to determine if they have been made in conformity with the law, and to submit the corresponding audit reports. Also, it submits annual reports and all other special reports that are required by the Legislative Assembly or the Governor.

Financial Reporting Entity

The Office is an entity of the Commonwealth, assigned to the Legislative Branch. For financial statement purposes, it is treated as a separate accounting entity. The Department of the Treasury of the Commonwealth serves as a trustee of the funds assigned to the Office by the Legislative Branch.

The administration of the Office is autonomous and is under the responsibility of the Comptroller of the Commonwealth, who is named by the Governor of Puerto Rico, with the consent of the Legislative Assembly.

Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net deficiency in assets 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 direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include appropriations that are restricted to meeting the operational or capital requirements of a particular function or segment.

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.

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

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

1. Organization and Summary of Significant Accounting Policies (continued)

Measurement Focus, Basis of Accounting, and Financial Presentation

they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the government 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.

The Office reports the general fund, which is the Office's primary operating fund. It accounts for all financial resources.

Assets, Liabilities, and Net Assets

Cash

The cash accounts of the Office are primarily maintained by the Department of Treasury of the Commonwealth of Puerto Rico, who administers the funds of the government. All the receipts and disbursements of the Office are made through the Governmental Development Bank of Puerto Rico, which maintains separate codes under the government general account in order to identify each separate agency. The disbursements and receipts related to travel and meals expenditures, as well as others, are maintained in the bank account of the Special Disbursement Officer of the Office.

Capital Assets

Capital assets, which include property and equipment, are reported in the governmental activities in the government-wide financial statements of the Office. Capital assets are defined by the government as assets with or estimated useful life in excess of five years. Such assets are recorded at historical cost or estimated historical cost. 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.

Property, plant and equipment is depreciated using the straight-line method over the following estimated useful lives:

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

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

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 up to a maximum 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, who have the right to such compensation up to the maximum allowed.

Insurance

The Office has an insurance coverage for its public facilities, primarily to provide protection against catastrophic losses. Also, the principal officers of the Office are covered under various policies. The Secretary of the Department of the Treasury is the agent in charge of acquiring the insurance coverages of the Office.

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 registration in books.
- The budget is prepared using modified accrual basis of accounting, except for encumbrances, as explained below:

The budgeted revenues presented in the *Statement of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual*, consisted of four joint resolutions for the year ended June 30, 2003 for operational appropriations of \$35,063,490.

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

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

1. Organization and Significant Accounting Policies (continued)

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

Expenditures according to the <i>Statement of Revenues, Expenditures and Changes in Fund Balance-Budget and Actual</i>	\$34,456,487
Plus prior years encumbrances recorded as expenditures during current year under the GAAP basis	1,422,806
Less current year encumbrances not recorded under GAAP basis	<u>269,140</u>
Expenditures according to the Statement of Governmental Fund Revenue, Expenditures and Changes in Fund Balance	<u>\$35,610,153</u>

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 a period of three years from the closing of the fiscal year for which they pertain.

The balance of encumbered and unencumbered funds as of June 30, 2003, are composed of the following:

Fiscal Year	Encumbered Funds	Unencumbered Funds
2001-2002	\$472,775	\$ 59,722
2002-2003	<u>269,140</u>	<u>607,003</u>
	<u>\$741,915</u>	<u>\$666,725</u>

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

2. Reconciliation of Government-Wide and Fund Financial Statements

Explanation of Certain Differences Between the Governmental Fund Balance Sheet and the Statement of Net Deficiency in Assets

The governmental fund balance sheet includes reconciliation between fund balance - total governmental funds and net assets and the governmental activities as reported in the government-wide statement of net assets. One element of that reconciliation explains that "long-term liabilities, not due and payable in the current period and therefore are not reported in the funds." The details of this difference are as follows:

Accrued vacations and sick leave- current	\$ 699,677
Accrued vacations and sick leave- long term	<u>8,041,050</u>
Net adjustment to reduce fund balance - total governmental funds to arrive at net deficiency in assets - statement of net deficiency in assets	<u>\$ 8,740,727</u>

Another element of that reconciliation is capital assets not reported in the funds. The details of this difference are as follows:

Capital assets	\$ 6,459,291
Accumulated Depreciation	<u>(4,388,704)</u>
Net adjustment to reduce fund balance - total governmental funds to arrive at net deficiency in assets - statement of net deficiency in assets	<u>\$ 2,070,587</u>

Explanation of Difference Between Governmental Fund Revenues, Expenditures and Changes in Fund Balances and the Statement of Activities

One element of the difference between governmental fund revenues, expenditures and changes in fund balances and the statement of activities is that the 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 and reported as depreciation expense.

Another element is that the compensated absences reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

3. Cash

The cash accounts of the Office are maintained together with the cash amounts of the Government of the Commonwealth of Puerto Rico, and no collateral is required to be maintained for these accounts.

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

4. Capital Assets

Capital asset activity for the year ended June 30, 2003 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance
Governmental activities				
Capital assets, being depreciated:				
Equipment	\$ 688,028	\$ 65,810	\$ 21,885	\$ 731,953
Electronic equipment	3,764,320	938,388	259,512	4,443,196
Furniture	852,289	211,386	10,669	1,052,906
Vehicles	231,236	-	-	231,236
Total capital assets being depreciated	5,535,873	1,215,484	292,066	6,459,291
Less accumulated depreciation for:				
Equipment	387,627	118,376	17,263	488,740
Electronic equipment	2,778,847	634,939	234,635	3,179,151
Furniture	506,252	103,543	6,467	603,328
Vehicles	94,188	23,297	-	117,485
Total accumulated depreciation	3,766,914	880,155	258,365	4,388,704
Total capital assets, being depreciated, net	<u>\$1,768,959</u>	<u>\$ 335,329</u>	<u>\$ 33,701</u>	<u>\$2,070,587</u>

5. Pension Plan

The Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (the System) is a cost-sharing multiple-employer defined benefit pension plan sponsored by, and reported as a component unit of, the Commonwealth of Puerto Rico. All regular employees of the Office under age 55, at the date of employment, become members of the System as a condition to their employment.

The System provides retirement, death and disability benefits pursuant to Act 447, approved on May 15, 1951, as amended, and became effective on January 1, 1952. Disability retirement benefits are available to members for occupational and nonoccupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

Participants who have attained an age of at least fifty-five (55) years and have completed at least twenty-five years of creditable service or participants who have attained age of at least fifty-eight (58) years and have completed at least ten (10) years of creditable service or participants who have attained age 65 with ten years of credited services if hired after April 1990, are entitled to annual benefit, payable monthly for life.

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

5. Pension Plan (continued)

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. In no case will the annuity be less than \$200 per month.

Participants who have completed at least thirty years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained fifty-five (55) years of age will receive 65% of the average compensation. Participants who have attained fifty-five (55) years of age will receive 75% of the average compensation. Disability retirement benefits are available to members for occupational and non-occupational disability. However, for nonoccupational disability a member must have at least ten (10) years of service.

No benefit is payable if the participant receives a refund of his accumulated contributions.

Employees accepted before April 1, 1990 are required to contribute from 5.775% of their salary, depending on the elected alternative. Employees accepted after such date, contribute 8.275% of their salary. The Office's contributions are 9.275% of gross salary. Total employee and employer contributions during the year ended June 30, 2003 amounted to approximately \$1,809,000. Total covered payroll during the year amounted to approximately \$19,500,000.

Additional information on the System is provided in its financial statements for the year ended June 30, 2003, a copy of which can be obtained from Mrs. Marisol Marchand Castro, Administrator, Retirement System Administration, PO Box 42003, San Juan, Puerto Rico 00949.

6. Lease Commitments

The Office rents its facilities through operating lease agreements in which the latest expires in 2006. Rent expense under such lease agreements for the year ended June 30, 2003 amounted to approximately \$1,250,000. Future minimum lease payments as of June 30, 2003 are as follows:

<u>Year Ending June 30</u>	
2004	\$1,330,969
2005	1,022,796
2006	<u>265,131</u>
	<u>\$2,618,893</u>

7. Legislative Appropriations

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

Office of the Comptroller of Puerto Rico
Notes to Financial Statements (continued)

8. 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.

**Report of Independent Auditors
on Compliance and Internal Control Over Financial Reporting
in Accordance with Government Auditing Standards**

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

We have audited the financial statements of the Office of the Comptroller of Puerto Rico (the Office), an agency assigned to the Legislative Branch of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 30, 2003. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United Offices.

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 and contracts, 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 an 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 over financial reporting that might be material weaknesses. 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 management of the Office in a separate letter dated November 30, 2003.

This report is intended solely for the information and use of the Office's management, and is not intended to be and should not be used by anyone other than this specified party.

Ernst + Young LLP

November 20, 2003

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this report.

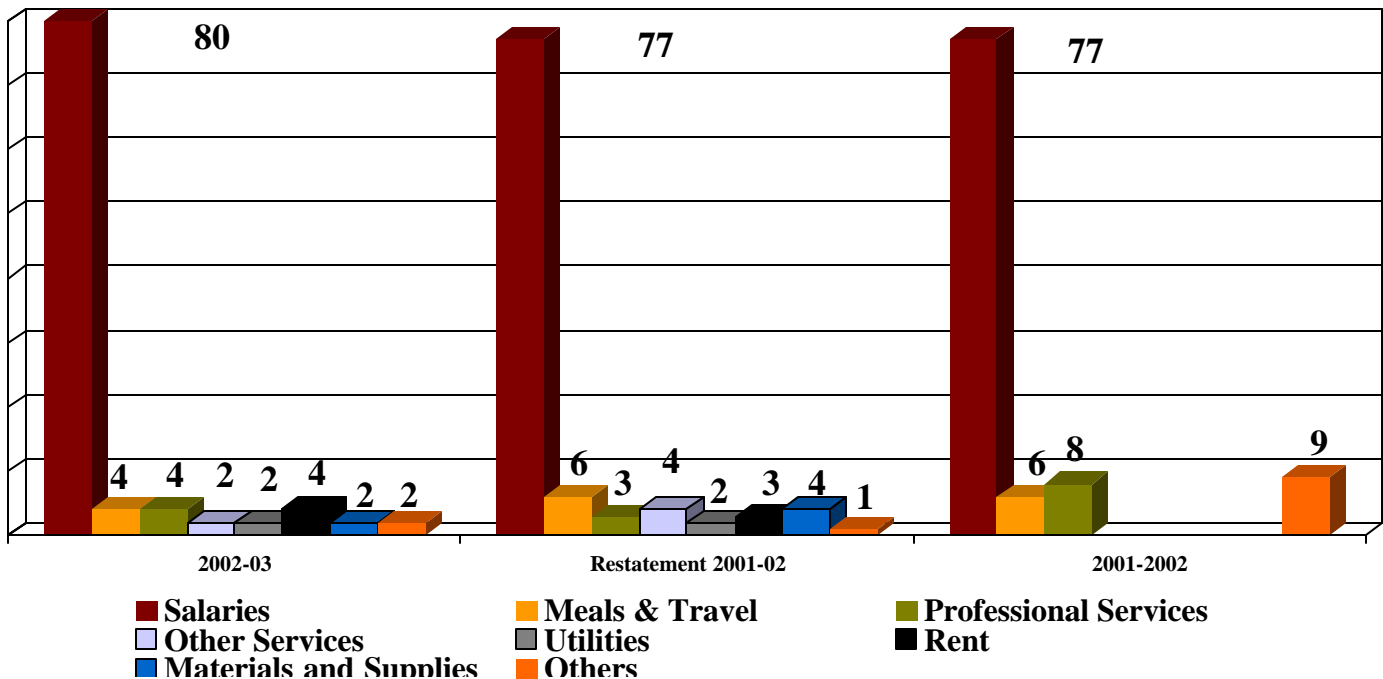
REPORT AND OPERATIONS

The table and chart that follow indicate the composition of the budget by line item, with respect to the total legislative appropriation.

The table and chart also present a comparative picture for two consecutive fiscal years, 2002-03 and 2001-02, including a restatement for the previous fiscal year for a better understanding and, due in part, to an amendment to Regulation No. 49 of the Treasury Department.

Chart 1 - Budget

	2002-03		Restatement 2001-02		2001-02	
Description	Appropriation	Percent	Appropriation	Percent	Appropriation	Percent
Salaries & fringe benefits	\$28,099,990	80	\$25,156,452	77	\$25,156,452	77
Meals and travel	1,475,000	4	1,817,466	6	1,817,466	6
Professional Services	1,487,259	4	1,071,915	3	2,487,105 ⁽¹⁾	8
Other Services	886,643	2	1,415,190	4		
Utilities	534,000	2	453,549	2		
Rent	1,225,618	4	1,113,451	3		
Materials and Supplies	773,541	2	1,279,360	4		
Others	581,439	2	221,069	1	3,067,429 ⁽²⁾	9
Total	<u>\$35,063,490</u>	<u>100</u>	<u>\$32,528,452</u>	<u>100</u>	<u>\$32,528,452</u>	<u>100</u>



⁽¹⁾ The amount of \$2,487,105 reported as Professional Services on our CAFR 2002 included \$1,071,915 for Professional Services and \$1,415,190 for Other Services.

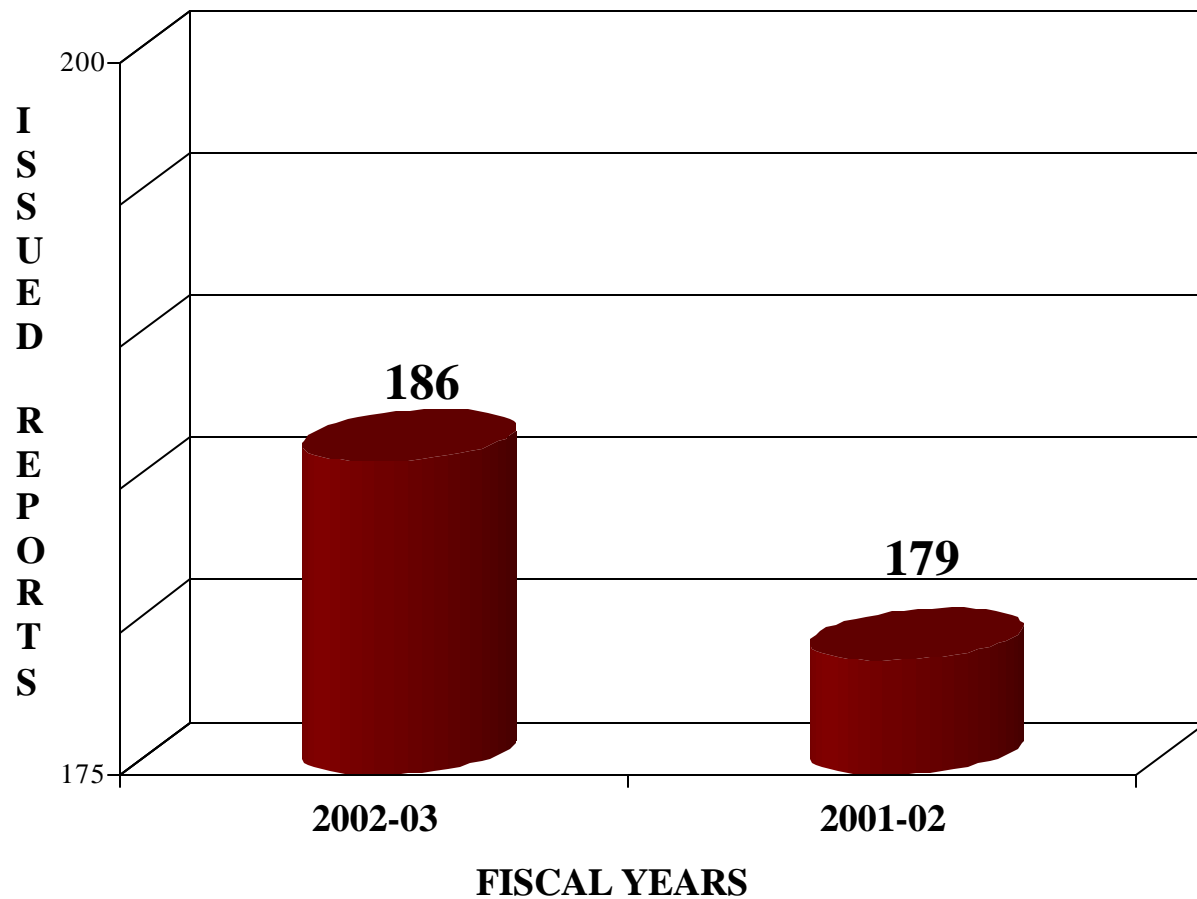
⁽²⁾ The amount of \$3,067,429 reported as Others on our CAFR 2002 included Utilities, Rent, Materials and Supplies and Others. A breakdown is included for a better understanding and, due in part, to an amendment to Regulation No. 49 (Chart of Account) of the Treasury Department.

ISSUED REPORTS

During fiscal year 2002-03, our Office issued 186 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 2002-03 and 2001-02.

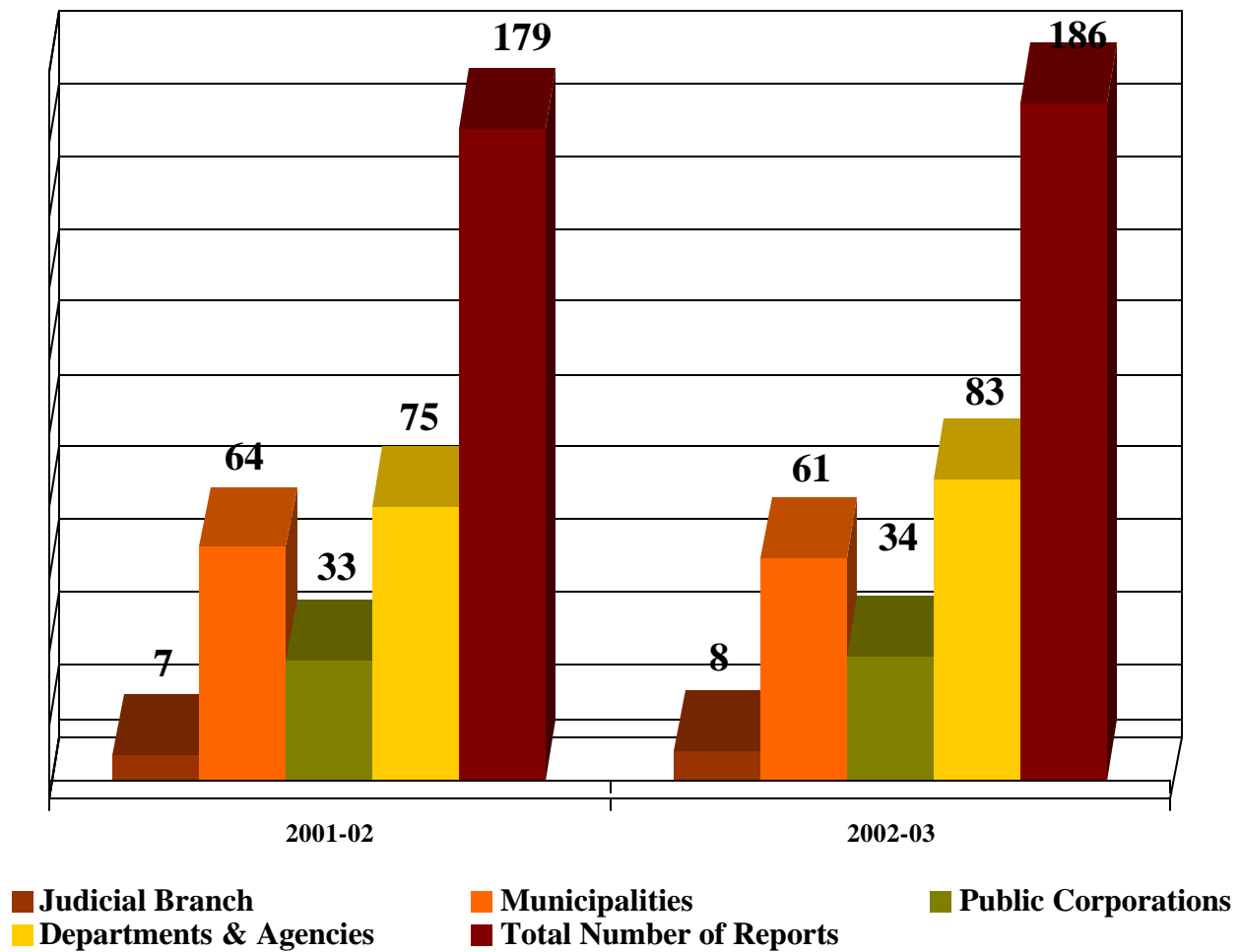
Chart 2 – Issued Reports



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 2001-02.

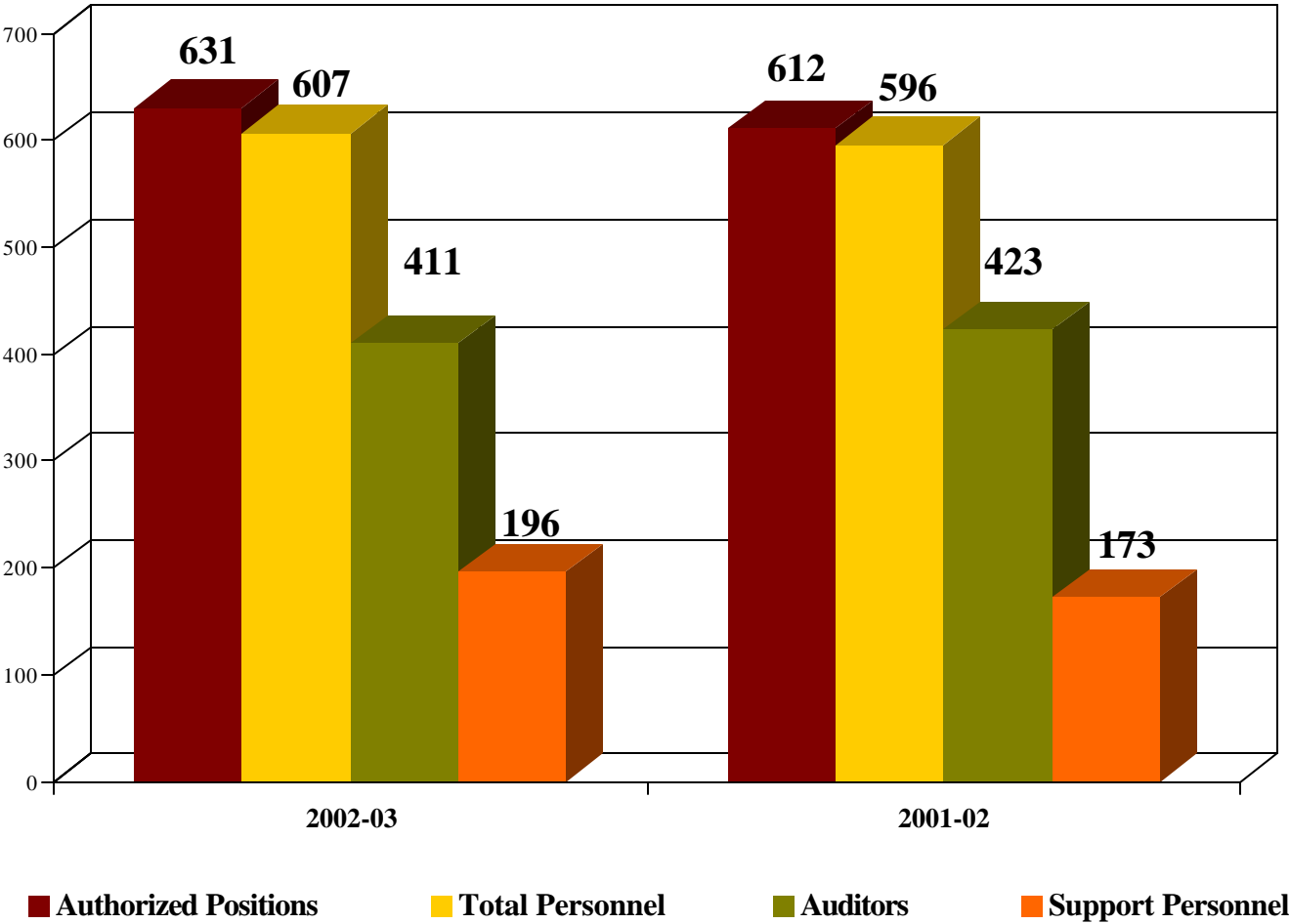
Chart 3 – Issued Reports by Entity



CAPITAL RESOURCES

This Chart shows the breakdown of audit and support personnel for fiscal years 2002-03 and 2001-02.

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

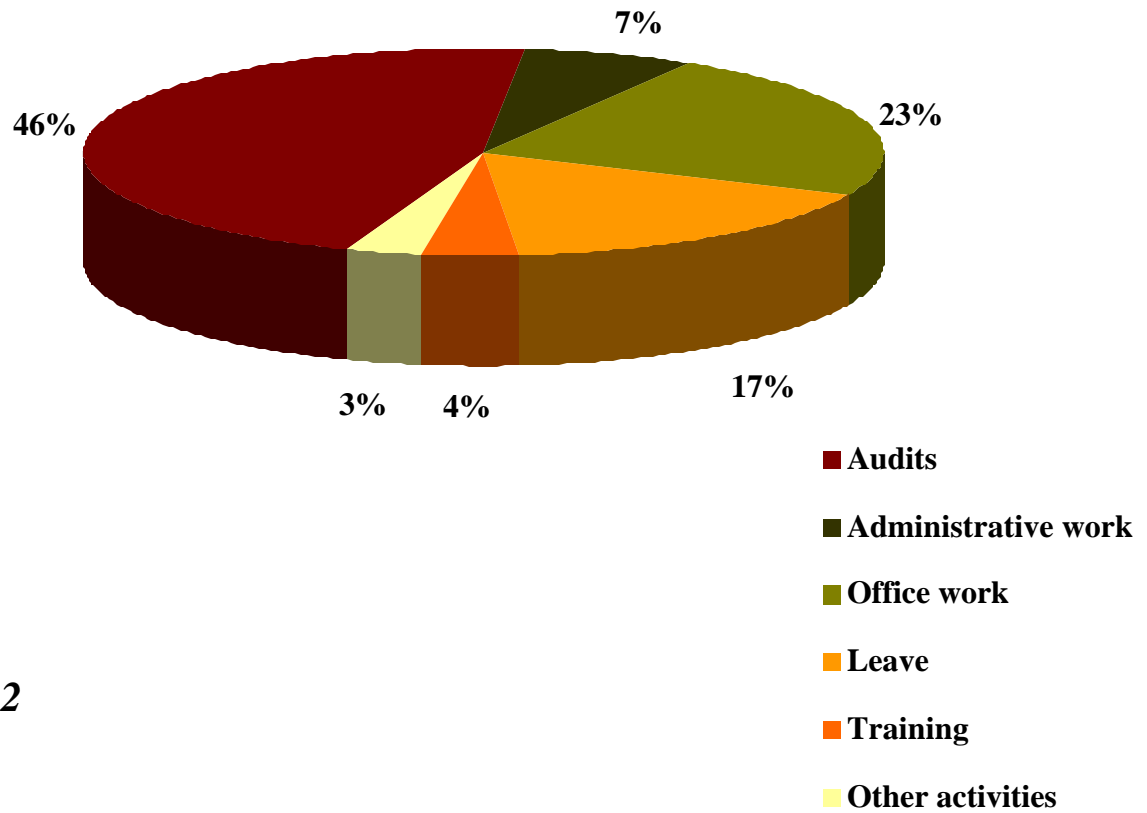


TIME DISTRIBUTION

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 2002-03 and 2001-02

2002-03



2001-02

