



Estado Libre Asociado de Puerto Rico
Oficina del Contralor

Yesmín M. Valdivieso
Contralora

August 30, 2019

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

In the exercise of our ministerial duty, we are pleased to enclose the Annual Report of the Office of the Comptroller of Puerto Rico, hereinafter referred to as the OCPR, for the fiscal years ended June 30, 2015 and June 30, 2016. The OCPR 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.

KPMG, our independent auditor, has finally issued an unmodified ("clean") opinion on the OCPR financial statements for the fiscal years ended June 30, 2015 and 2016. The independent auditors' report is located at the front of the financial section of those reports. These statements, although ready since September, 2015 and October, 2016, respectively, were not issued before as our auditors were waiting for the net pension liability amounts required by the Government Accounting Standards Board in Standard 68.

Management's Discussion and Analysis (MD&A) immediately follow the independent auditors' reports and provide a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

Following the MD&A are the basic financial statements, including the general fund balance sheet and statement of net position, the statement of general fund revenue, expenditures and changes in fund balance and statement of activities, and the notes to financial statements. The statistical section, completes this report. It provides information about finances, economics, and operational matters related to the OCPR that is generally presented on a comparative basis.

Respectfully submitted,


Yesmín M. Valdivieso



COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER

ANNUAL REPORT

FOR FISCAL YEAR ENDED
JUNE 30, 2016



TQM A 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 and safe-keeping of the people's moneys and properties.

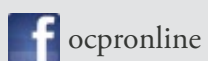
The satellite orbiting above the earth represents the era of information technology systems and telecommunications.

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

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

To improve the oversight function and administration of public funds and property is a commitment of all.

Additional information related to the Office of the Comptroller of Puerto Rico is available through the Internet at www.ocpr.gov.pr



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, and address other matters entrusted. To promote the effective, economical, efficient, and ethical use of government resources for the benefit of our people.

VISION

To serve Puerto Rico with a modern and technological Comptrollership that will carry out advanced audits and investigations, to achieve good government through our experience and knowledge support.

VALUES

COMMITMENT

We offer the best of our capabilities, talent, energy and effort.

EXCELLENCE

We are relentless in our efforts to perform to the best of our capabilities.

INTEGRITY

We demonstrate honesty and reliability in the constant execution of our duties.

JUSTICE

We promote solutions, methods and processes based on maintaining balance and respect of rights. We observe and respect legal equality.

RESPECT

We are pleasant and considerate. We accept diversity and individual qualities.

RESPONSIBILITY

We are thorough in the manner in which we carry out our duties and accept the consequences of our actions and decisions.

SENSIBILITY

We are empathic and treat others without prejudgments.

TRANSPARENCY

We express ourselves with clarity and act with confidence and legality.

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Commonwealth of Puerto Rico OFFICE OF THE COMPTROLLER

GENERAL INFORMATION

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.

On July 1, 2010, I took office as Comptroller, after being designated by the Governor with the advice and consent of the Legislature, as required 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 OCPR has organized all government entities of the Executive, Legislative, and Judicial branches, into 515 units, as of June 30, 2016 for auditing or examination purposes. This figure includes departments, agencies, public corporations, and municipalities.

Results, including findings and recommendations, are presented in audit and special reports, thus providing for appropriate corrective actions. Violations of law are referred to the appropriate administrative, civil, or criminal law enforcement agencies.

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

STRATEGIC PLAN

The OCPR operates according to the four year Strategic Plan 2014-17, approved on December, 2013. To achieve our mission and vision statements, and meet our statutory responsibilities, we developed our Plan which consists of two strategic goals, six strategic objectives, and performance goals and initiatives to support what we want to achieve. The Plan was developed with the participation of 120 executives in three, one day sessions. The mission and values were revised and ideas to develop the goals, objectives and initiatives were considered to define the execution plans. The vision declaration was changed with a focus to serve Puerto Rico with a modern and technological Comptrollership that will carry out state of the art audits and investigations, to achieve good government through our experience and knowledge support.

Each year we establish the objectives that we propose to accomplish, depending on the resources that are assigned to the OCPR. During fiscal year 2015-2016 we attained significant goals using the managerial philosophy of Total Quality Management (TQM) to optimize the use of funds that have been assigned to conduct our operations.

OVERSIGHT

During fiscal year 2015-16, we published 117 audit reports, and 7 special reports. The audit reports correspond to the Executive Branch (67), the Judicial Branch (4), and municipalities (46). The audit reports contained 2,488 situations: in the Executive Branch (991), the Judicial Branch (14), and municipalities (1,483). Six special reports contained 47 situations related to Executive Branch (19) and municipalities (28). In Chart 4 we present the classification of the most important findings. On these reports we included 1,940 recommendations: to the Governor (9), the President of the Senate and the Speaker of the House of Representatives (10), the Department of Justice (21), the Treasury Department (2), the Office of Government Ethics of Puerto Rico (9), the principal officers of the entities (1,675), and others (214).

PREVENTION

1. Professional guidance concerning sound public administration were offered to 5,119 government officials and employees during fiscal year 2015-16. This amount includes lectures offered to 3,235 members of the public schools councils in compliance with Act. No. 77-2006, as amended; 52 officials on the proper use of public property and funds in compliance with Act. No. 78-2011, as amended, and 140 executives appointed by the Governor of Puerto Rico in compliance with Act. No. 190-2006. In addition, it includes lectures offered to 1,692 officials and employees from different state government agencies, public corporations and municipalities.
2. Participated in the Domestic Working Group annual meeting of the Governmental Accountability Office (GAO) in Washington, DC.
3. Participated in the XXV General Assembly of the *Organización Latinoamericana y del Caribe de Entidades Fiscalizadoras Superiores (OLACEFS)* in Santiago de Querétaro, México on November 23 – 27, 2015.
4. Participated in the XXXIX General Assembly of the *Organización Centroamericana y del Caribe de Entidades Fiscalizadoras Superiores (OCCEFS)* in La Romana, Dominican Republic on June, 10 – 12, 2015.
5. Attended the NASACT Annual Conference.
6. Participated in the virtual course: *X Curso Subsede Herramientas Prevención y control en el enfrentamiento a la Corrupción* hosted by Cuba.
7. Answered four surveys from various Supreme Audit Institutions around the world, about topics such as trainings and stakeholders.
8. Nineteen circular letters were issued during fiscal year 2015-16. Among the most important letters are:
 - a. Circular Letter OC-16-05 dated August 14, 2015 - *Cumplimiento de las recomendaciones incluidas en nuestros informes de auditoría y especiales.*
 - b. Circular Letter OC-16-06 dated October 1, 2015 - *Orientación sobre el Gasto Público en la Realización de Actividades Durante la Época Navideña.*
 - c. Circular Letter OC-16-07 dated October 8, 2015 - *Uso de tarjetas de crédito del Gobierno del Estado Libre Asociado de Puerto Rico.*

- d. Circular Letter OC-16-08 dated October 8, 2015 - *Orientación sobre la concesión de auspicios y de donativos.*
- e. Circular Letter OC-16-09 dated October 30, 2015 - *Ley Núm. 96 del 26 de junio de 1964, según enmendada, sobre la investigación respecto a la pérdida de propiedad y fondos públicos, y la notificación correspondiente a la Oficina del Contralor y al Departamento de Justicia.*
- f. Circular Letter OC-16-12 dated January 15, 2016 - *Oficina de Querellas e Inteligencia Fiscal de la Oficina del Contralor de Puerto Rico.*
- g. Circular Letter OC-16-15 dated February 5, 2016 - *Limitaciones en las actuaciones de los policías municipales.*
- h. Circular Letter OC-16-16 dated February 9, 2016 - *Evaluación de los controles de los sistemas de información computadorizados de los municipios.*
- i. Circular Letter OC-16-17 dated May 20, 2016 - *Limitación en año de elecciones sobre el uso de fondos públicos en las agencias.*
- j. Circular Letter OC-16-19 dated June 15, 2016 - *Guía Rápida sobre la Reglamentación en el Gobierno.*

HUMAN CAPITAL

1. Office-wide training was offered on techniques for the detection of illegal use of controlled substances, sexual harassment, and other forms of discrimination.
2. All personnel were trained on Government Ethics.
3. Fringe benefits and government contribution to the Medical plan were maintained to retain and attract highly qualified personnel.
4. Engaged in special activities as part of our commitment with the community and to comply with our social responsibility objective. Among them:
 - United Fund Campaign.
 - Participated in activities with the Muscular Dystrophy Association.
 - Donated surplus equipment to schools and other non-profit organizations.
5. The OCPR continued providing services as established in the Personnel Support Program empowered by Act No. 9 of July 24, 1952, as amended. The Program's philosophy and goals are directed to assist our fellow-workers and their families, primarily for problems related to marital or family situations, work conditions, emotional aspects, and adolescence guidance, among others. The Program is voluntarily guided, and it is considered an innovative initiative to improve the quality of life of our personnel.
6. Internship Program: provides qualified university students the opportunity for learning government operations through the audits that the Office performs. Also to develop and encourage interest in public service.

TECHNOLOGY

1. Contract Registry application improved with two versions; 4.5 and 4.6.
2. An internal complaints system was effectively placed in production as requested by the Office of the Internal Auditor.
3. Registry of Losses and Irregularities application via version 5.1. This registry is mandated by Act 96 and pertains to proper notification via registry of losses and or irregularities concerning public funds and property.
4. Government Information Center functionality improved via version 2.0.
5. Annual Certification application was augmented with an administrative model. This was achieved via version 2.0.
6. Version 11.1.3 of TeamMate, our backbone auditing application, was successfully implemented.
7. A new portal was developed and implemented by and for the Information Systems division. This portal serves as a centralized document repository of the service entities of the division.
8. Microsoft Office applications were successfully upgraded to the 2013 Pro-Plus version on all agency computers.
9. All agency users' email were successfully migrated to Microsoft Cloud, Office 365.
10. The replacement of Microsoft Lync Communicator with Skype for Business augmenting our internal communications.
11. Developed and placed into production an application that permits public access to contract research or lookup without disclosure of the entity social security number or other private data.
12. Remote access VPN client software effectively upgraded to FortiClient v 5.2.3.
13. WAP's [wireless access points] were installed in conference rooms throughout both buildings.
14. Phase 1 of the Information Systems division restructuring project based upon ITIL processes, job descriptions and related items was implemented.

TOTAL QUALITY MANAGEMENT

IMPROVING PROCESSES

Continued with our commitment to analyze existing processes in our organization, improving them, and identifying the pertinent variables and factors so as to monitor behavior, measure progress, and control the processes. During fiscal year 2015-16, we implemented recommendations to improve the Complaints Process, the Corrective Action Plan Process and the Government Information Center related to the audit function. Cooperation Agreements with the Department of Labor and Human Resources and the Department of

Justice to access data bases were formalized. Also, we conducted surveys to measure customer satisfaction of the orientations offered to the members of school councils, required by Act 77-2006, as amended. The OCPR met 90 percent of the quality objectives defined for the year.

ISO (INTERNATIONAL ORGANIZATION FOR STANDARDIZATION)

ISO (word derives from the Greek isos, meaning “equal”) is the world’s largest developer and publisher of International Standards. ISO is a network of the national standards bodies of 163 countries, on the basis of one member per country, with a Central Secretariat in Geneva, Switzerland, that coordinates the system. Through its members, it brings together experts to share knowledge and develop voluntary, consensus-based, market relevant International Standards that support innovation and provide solutions to global challenges.

The quality management system standards of the revised ISO 9001:2008 series are based on eight principles (all fundamental to good business practices) that can be used by senior management as a framework to guide their organizations towards improved performance. The eight quality management principles are: Customer Focus, Leadership, Involvement of People, Process Approach, Systems Approach to Management, Continual Improvement, Fact Based Decision Making and Mutually Beneficial Supplier Relationships.

On November 11, 2015, Bureau Veritas, a widely recognized certification body in the world, re-certified the compliance of our Quality Management System (QMS) against the 9001:2008 international standard, without any non-conformances detected. The certification is valid for the next three years, contingent to successful periodic follow up audits.

THE CORRECTIVE ACTION PLAN

The Corrective Action Plan (CAP) is a follow-up mechanism that ensures compliance with the recommendations made by the OCPR in its audit reports. This program was implemented pursuant to the provisions of Act No. 9, of July 24, 1952 which allows the Comptroller, in the exercise of her authority, to adopt practices and procedures generally accepted in current auditing practices. On May 6, 1988, the Governor 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. On November 1, 1990, the Office approved Regulation No. 26 implementing the CAP. On June 13, 1998, the Governor issued Executive Order OE-1998-16, superseding Executive Order 5098D. In addition, on September 11, 2009, the Office approved Regulation No. 26 implementing the CAP, superseding previous regulation.

By June 30, 2016, the OCPR had received 663 and evaluated 634 CAPs to ascertain compliance with the recommendations contained in the audit reports; this represents 96 percent of the evaluations. This figure includes initial CAPs and complementary reports. During fiscal year 2014-15 the OCPR received 590 and evaluated 557 CAPs, the 33 remaining were evaluated during fiscal year 2015-16. The Executive Order 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 auditors’ management letters. If, upon due consideration, the chief executive determines that the recommendations of the external auditors cannot be adopted, this determination should be appropriately documented and sustained.

The entire operation of the CAP continues to be reviewed, since optimum efficiency wants to be reached in the follow-up process, in order to increase compliance with the recommendations and develop quicker and accurate statistical data. On March 1, 2010, we implemented a process which allows the government entities to send the CAPs and complementary reports information using electronic mail.

PUBLIC REGISTRY OF GOVERNMENT CONTRACTS

According to Act No. 18 of October 30, 1975, as amended, 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 register and submit a copy of their contracts, deeds, and amendments to the OCPR 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 33 of September 15, 2009.

The OCPR uses the Registry for verification purposes as part of its oversight role. On October 15, 2009, we implemented a version of the Registry which allows government agencies, among other enhancements, to send digitized copies of the contracts using the Internet. The Registry is accessible to the general public via Internet since 1999 at www.ocpr.gov.pr. Interested parties may request copies of these contracts. A nominal fee is required for each copy. The OCPR received 648 requests and submitted 5,335 copies during fiscal year 2015-16. During fiscal year 2014-15 it received 657 requests and submitted 3,713.

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 reference fields or clues such as: contract number, name of the contractor, date of execution, dollar amount and 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.

REGISTRY OF LOSSES OR IRREGULARITIES OF PUBLIC FUNDS OR PROPERTY

The OCPR instituted a computerized registry system on October 30, 2013 in which government entities register the information related to losses or irregularities with public funds or property. This computerized system was established in compliance with the provisions of Act 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.

REGISTRY OF PRIVATIZATIONS

Act No. 136-2003, as amended by Act No. 71-2007, requires all government entities, including public corporations and municipalities, to submit an annual report of all privatizations of functions, areas of administration, or duties of their entities to the Governor, the Legislature and the Office of the Comptroller. Additionally, they have to submit information related to contracts, budget, projects, obligations, internal controls, real property and an independent financial and administrative evaluation of said privatizations. The

OCPR is required to maintain a registry on all reports received. The Registry is accessible to the general public via Internet at www.ocpr.gov.pr.

GOVERNMENT EXPENSES AND EMPLOYMENT REGISTRY

According to Act No. 103-2006, every agency that receives funds from the government's General Fund has to submit by December 31 of each year, to the secretaries of the House of Representatives and Senate of Puerto Rico, the Office of the Comptroller, and the Office of Management and Budget (OMB), a certification signed and sworn by the Director of Finance and the Agency Executive. This certification must contain, among other things: the number of job posts by category at the beginning and at the end of the fiscal year, including the payroll budget; professional services received and analysis of expenses during the fiscal year; and all its funding sources from the general fund, special assignments, state and federal funds, and other income. In addition, Act No. 103-2006 created a Job Registry, monitored by the Office of the Comptroller, which requires that all agencies, public corporations and municipalities report, on a monthly basis, all occupied job posts and vacancies. The registry has been designed by the OCPR and is available online through the website with the title Job Registry under Contraloría Digital.

RESULTS OF OPERATIONS

BUDGET

The budget assigned to the OCPR for fiscal year 2015-16 was \$39,690,000, it represented a decrease of \$625,000 compared to the previous year. The OCPR spent and encumbered \$39,120,659 leaving an unexpended balance of \$569,341. This balance is available for non-recurring expenses. Specific information is presented in the Statistical Section of this Report. (Chart 1)

HUMAN CAPITAL

As of June 30, 2016 the Office had 582 full time occupied positions or 83 percent out of 701 authorized positions; 372 were auditors and 210 were support personnel. Support personnel consist of legal counsels, administrative staff, and other professionals (Chart 2). During 2015-16, 14 auditors and 6 support personnel resigned or retired, while 1 auditor was hired. A grand total of 888,221.55 hours were dedicated to audits, service and administrative support, information and communication systems, trainings, and prevention and anti-corruption. (Chart 3)

TRAINING

The OCPR has established an internal regulation that requires support personnel to take a minimum of 15 hours of continued education annually. Auditors are required a minimum of 80 hours every 2 years; 24 have to be in areas related to the profession. Auditors of the Information Technology Audit Division are required 20 hours in computer information systems.

During 2015-16, 24,533.75 hours were dedicated to training and education. Seminars and conferences in auditing, management, report writing, grammar skills, leadership, supervision, and recent developments in information technology have been a priority.

FINANCIAL INFORMATION

INTERNAL CONTROLS

The OCPR 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.

The OCPR has regulations to strengthen the independence, integrity, and trust on the Office's internal auditing activity and the transparency in its fiscal processes and transactions.

BUDGETARY CONTROLS

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

INDEPENDENT AUDIT


KPMG, LLP an independent certified public accounting firm, performed the audit of the financial statements of the OCPR for fiscal year ended June 30, 2016. The Independent Auditors' Report is included in the Financial Section. The accounting firm performed the audit on time as expected. However, OCPR received the audited financial statements on February 19, 2019.

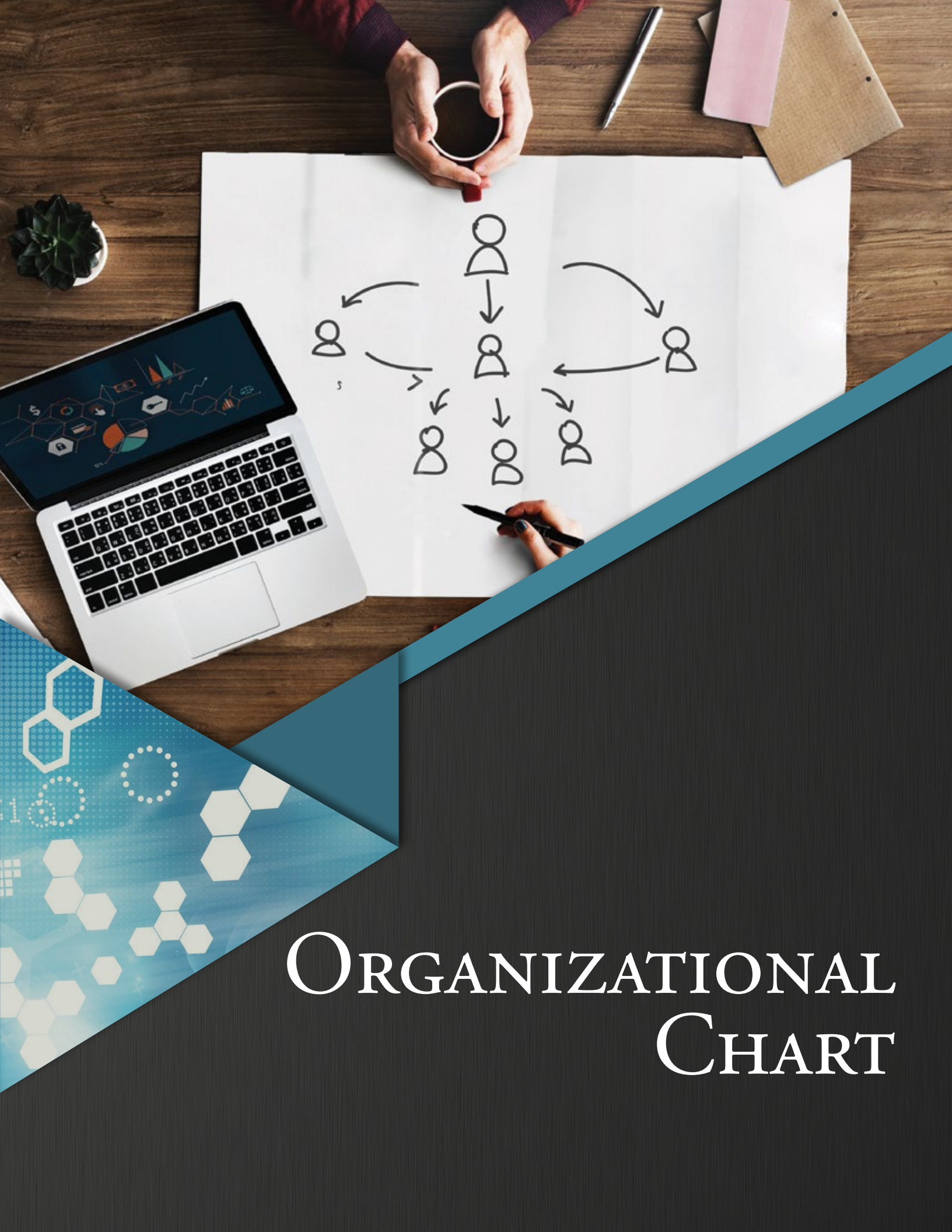
FINANCIAL REPORTING

The OCPR complies with all financial reporting requirements.

Improving the oversight function and administration of public funds and property is a commitment of all.

Respectfully submitted,


Yesmín M. Valdivieso
August 30, 2019

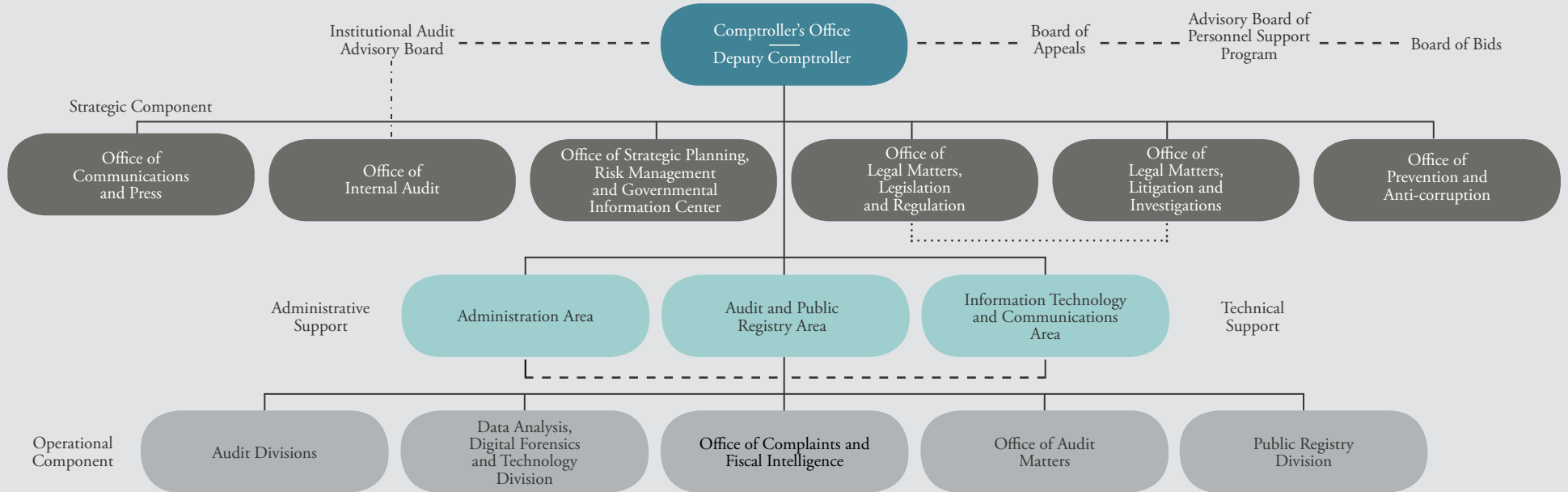


ORGANIZATIONAL CHART



COMMONWEALTH OF PUERTO RICO OFFICE OF THE COMPTROLLER

ORGANIZATIONAL CHART



- - - - Consulting and Advisory Areas

..... Technical Control and Coordination Areas

- . - . - . Reports to Institutional Advisory Board and Administratively to the Comptroller



PRINCIPAL OFFICERS

PRINCIPAL OFFICERS

OFFICE OF THE COMPTROLLER

Hon. Yesmín M. Valdivieso
COMPTROLLER

Natanael Arroyo Cruz
DEPUTY COMPTROLLER

Miriam T. Contreras Amador
ASSISTANT COMPTROLLER
ADMINISTRATION AREA

Edgardo Castro Rivera
EXECUTIVE DIRECTOR
OFFICE OF PREVENTION
AND ANTI-CORRUPTION

Jamiel Miranda Matos
EXECUTIVE DIRECTOR
OFFICE OF STRATEGIC PLANNING,
RISK MANAGEMENT AND
GOVERNMENTAL INFORMATION
CENTER

Lilliam M. Feliciano Solero
EXECUTIVE DIRECTOR
OFFICE OF LEGAL MATTERS,
LEGISLATION AND REGULATION

Nilsa T. Añeses Loperena
EXECUTIVE DIRECTOR
OFFICE OF LEGAL MATTERS,
LITIGATION AND INVESTIGATIONS

Myriam J. Flores Santiago
DIRECTOR OF INTERNAL AUDIT

Lisandra Rivera Rivera
DIRECTOR OF
COMMUNICATIONS AND PRESS

AUDIT AND PUBLIC REGISTRY AREA

Yamira Pérez Ortiz
EXECUTIVE DIRECTOR
OFFICE OF AUDIT MATTERS

Héctor A. Rivas Ortiz
AUDIT DIRECTOR
DEPARTMENTS AND AGENCIES
DIVISION

Julio J. Dávila Bravo
AUDIT DIRECTOR
PUBLIC CORPORATIONS DIVISION

Arnaldo L. Negrón Otero
AUDIT DIRECTOR
MUNICIPALITIES DIVISION

Lourdes Díaz Valcárcel
AUDIT DIRECTOR
INFORMATION TECHNOLOGY
DIVISION

Nydia I. Hernández Matos
AUDIT DIRECTOR
FINANCIAL MATTERS AND
RETIREMENT
SYSTEMS DIVISION

Iván D. Denizac González
DIRECTOR
DATA ANALYSIS, DIGITAL FORENSICS
AND TECHNOLOGY DEVELOPMENT
DIVISION

Suzanne Benítez Matos
DIRECTOR OF PUBLIC REGISTRY
DIVISION

Egda M. Pagán Rivera
DIRECTOR
OFFICE OF COMPLAINTS AND FISCAL
INTELLIGENCE

ADMINISTRATION AREA

Oscar A. Luna Díaz
DIRECTOR
FINANCE AND BUDGET DIVISION

Iseut G. Vélez Rivera
DIRECTOR
HUMAN CAPITAL DIVISION

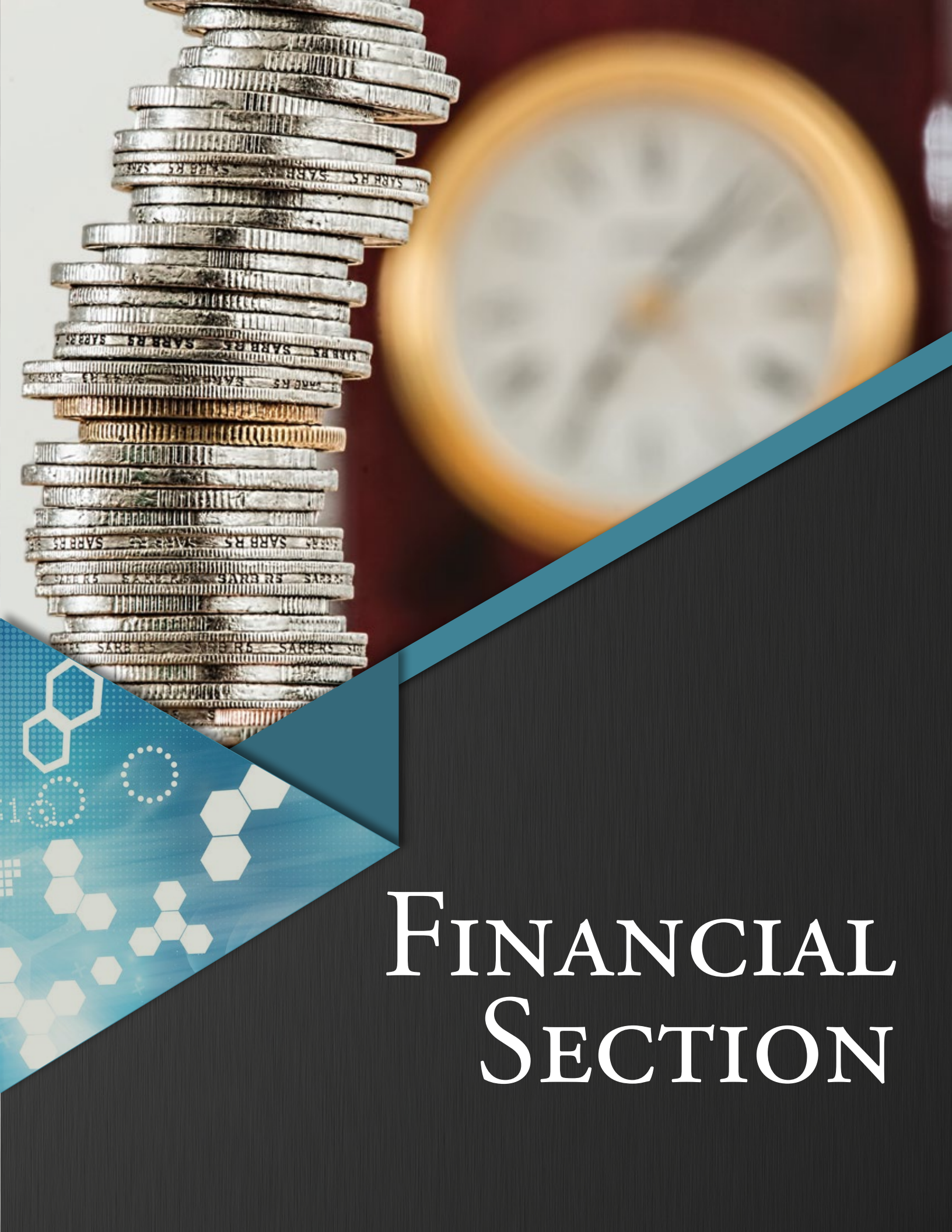
Elsa S. Páez Guerrero
DIRECTOR
GENERAL SERVICES DIVISION

Mara E. Reyes Alfonso
DIRECTOR
PROFESSIONAL DEVELOPMENT
CENTER AND SPECIAL ACTIVITIES

Carlos A. Pérez Rivera
ADMINISTRATOR
PUBLIC DOCUMENTS
ADMINISTRATION PROGRAM

INFORMATION TECHNOLOGY AND COMMUNICATIONS AREA

N'gai Oliveras Arroyo
DIRECTOR OF INFORMATION SYSTEMS



FINANCIAL SECTION



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

(An Agency of the Commonwealth of Puerto Rico)

Financial Statements and Required Supplementary Information

June 30, 2016

(With Independent Auditors' Report Thereon)

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

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KPMG LLP
American International Plaza
Suite 1100
250 Muñoz Rivera Avenue
San Juan, PR 00918-1819

Independent Auditors' Report

The Comptroller of Puerto Rico
Office of the Comptroller:

We have audited the accompanying financial statements of the governmental activities and General Fund of the Office of the Comptroller of the Commonwealth of Puerto Rico (the Office), an agency of the Commonwealth of Puerto Rico (the Commonwealth), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Office's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and General Fund of the Office of the Comptroller of the Commonwealth of Puerto Rico as of June 30, 2016 and, the respective changes in financial position for the year then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matters

An Agency of the Commonwealth of Puerto Rico

As discussed in note 1, the financial statements of the Office, an agency of the Commonwealth, are intended to present the financial position and changes in financial position of only that portion of the governmental activities and the General Fund of the Commonwealth that is attributable to the transactions of the Office. They do not purport to, and do not, present fairly the financial position of the Commonwealth as of June 30, 2016, or the changes in its financial position, for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Going Concern – Commonwealth of Puerto Rico

As more fully described in note 2 to the financial statements, the Office is an agency of the Commonwealth. The Commonwealth has incurred recurring deficits, has a negative financial position, has experienced further deterioration of its economic condition, has not been able to access the credit markets, and has stated that substantial doubt exists about the Commonwealth's ability to continue as a going concern. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3 through 8 and the schedules of employer's share of net pension liability and related ratios, employer's contributions, and budgetary information on pages 29 through 31 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 19, 2019 on our consideration of the Office's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Office's internal control over financial reporting and compliance.

KPMG LLP

San Juan, Puerto Rico
February 19, 2019

Stamp No. E363682 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2016

The Office of the Comptroller (the Office), an agency assigned to the Legislative Branch of the Commonwealth of Puerto Rico (the Commonwealth), offers to the readers of the financial statements this narrative overview and analysis of the financial activities of the Office for the fiscal year ended June 30, 2016.

Financial Highlights

- Total liabilities of the Office's governmental activities at the close of the fiscal year ended June 30, 2016 amounted to approximately \$182,000,000 comprising primarily of the net pension liability in the total amount of approximately \$170,000,000.
- The liabilities and deferred inflows of resources exceeded total assets and deferred outflows of resources by approximately \$144,000,000 mainly from the net pension liability.
- The Office's total net position decreased by approximately \$10,250,000 in fiscal year 2016 when compared to prior year net position of approximately \$134,000,000, mainly as a result of the change in the net pension liability.
- The Office's total assets and deferred outflows of resources increased by approximately \$15,000,000.
- The Office's net investment in capital assets decreased by approximately \$470,000.
- The final budget of the Office for fiscal year 2015–2016 was \$39,690,000. It represents a decrease of \$625,000 when compared to the 2014–2015 budget.

The Office's revenues and other financing sources exceeded its budgetary basis expenditures by approximately \$580,000 for the fiscal year 2015–2016.

Overview of the Basic Financial Statements

This Management's Discussion and Analysis section is intended to serve as an introduction to the Office's basic financial statements. The Office's basic financial statements comprise three components:

- 1) government-wide financial statements on all of the activities of the Office, 2) fund financial statements, and 3) notes to basic financial statements.

Government-Wide Financial Statements

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

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

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

(Continued)

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
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Management's Discussion and Analysis (Unaudited)
June 30, 2016

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

Fund Financial Statements

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

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

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

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

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 11 to 28 of this report.

Financial Analysis of the Governmental Activities

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

(Continued)

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2016

Net Position

The statement of net position serves as an indicator of the Office's financial position at the end of fiscal year. The Office's net position decreased by approximately \$10,250,000, when compared with the prior year balance. The Office's net position includes net investment in capital assets for approximately \$1,600,000 and an unrestricted deficit of approximately \$146,000,000. The following is condensed summary information for fiscal years ended June 30, 2016 and 2015.

Condensed summary information of net position			
	2016	2015	Change
Current assets	\$ 6,170,129	6,139,355	30,774
Capital assets, net	1,601,524	2,069,688	(468,164)
Total assets	7,771,653	8,209,043	(437,390)
Deferred outflows of resources	33,159,437	18,159,293	15,000,144
Total assets and deferred outflows of resources	\$ 40,931,090	26,368,336	14,562,754
Current liabilities	\$ 944,813	1,281,043	(336,230)
Noncurrent liabilities	181,121,988	157,986,918	23,135,070
Total liabilities	182,066,801	159,267,961	22,798,840
Deferred inflows of resources	2,943,533	928,269	2,015,264
Total liabilities and deferred inflows of resources	\$ 185,010,334	160,196,230	24,814,104
Net position:			
Net investment in capital assets	\$ 1,601,524	2,069,688	(468,164)
Unrestricted – deficit	(145,680,768)	(135,897,582)	(9,783,186)
Total net position	\$ (144,079,244)	(133,827,894)	(10,251,350)

Total assets of the Office's at June 30, 2016 decreased by approximately \$440,000 when compared to the total assets as of June 30, 2015 primarily attributable to 2016 depreciation and amortization of approximately \$531,000.

Deferred outflows of resources, which represents resources applicable to a future reporting period, increased by approximately \$15,000,000 when compared to deferred outflows of resources at June 30, 2015. The increase in 2016 resulted primarily from the pension plan employer's contributions made subsequent to the measure date and from pension activities related to changes in assumptions and changes in proportion and differences between employer contributions and proportionate share of contributions.

(Continued)

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2016

Total liabilities at June 30, 2016 increased by approximately \$22,800,000 when compared to total liabilities at June 30, 2015. This increase is mainly resulted from the increase in the net pension liability which totaled approximately \$170,000,000 at June 30, 2016, an increase of approximately \$22,800,000 when compared to net pension liability at June 30, 2015.

Deferred inflows of resources, which is an acquisition of resources by the Office that is applicable to a future reporting period, amounted to approximately \$3,000,000 at June 30, 2016. The increase of approximately \$2,000,000 when compared to June 30, 2015 resulted from changes in the deferred inflows of resources from pension activities related to differences between expected and actual experience and net difference between projected and actual earnings on pension plan investments.

Capital Assets

The capital assets of the Office are those assets that are used in the performance of its functions. The net investment in capital assets for the fiscal year ended June 30, 2016 amounts to approximately \$1,600,000. The Office's capital assets, net decreased during 2016 by approximately \$470,000.

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

- The retirement of equipment, electronic equipment, furniture, and software in the net amount of approximately \$250,000,
- The acquisition of software including capitalization of internally developed software in the amount of approximately \$67,000,
- Current year's depreciation and amortization of approximately \$530,000, and
- The acquisition of equipment, vehicle and furniture at a cost of approximately \$246,000.

Changes in Net Position

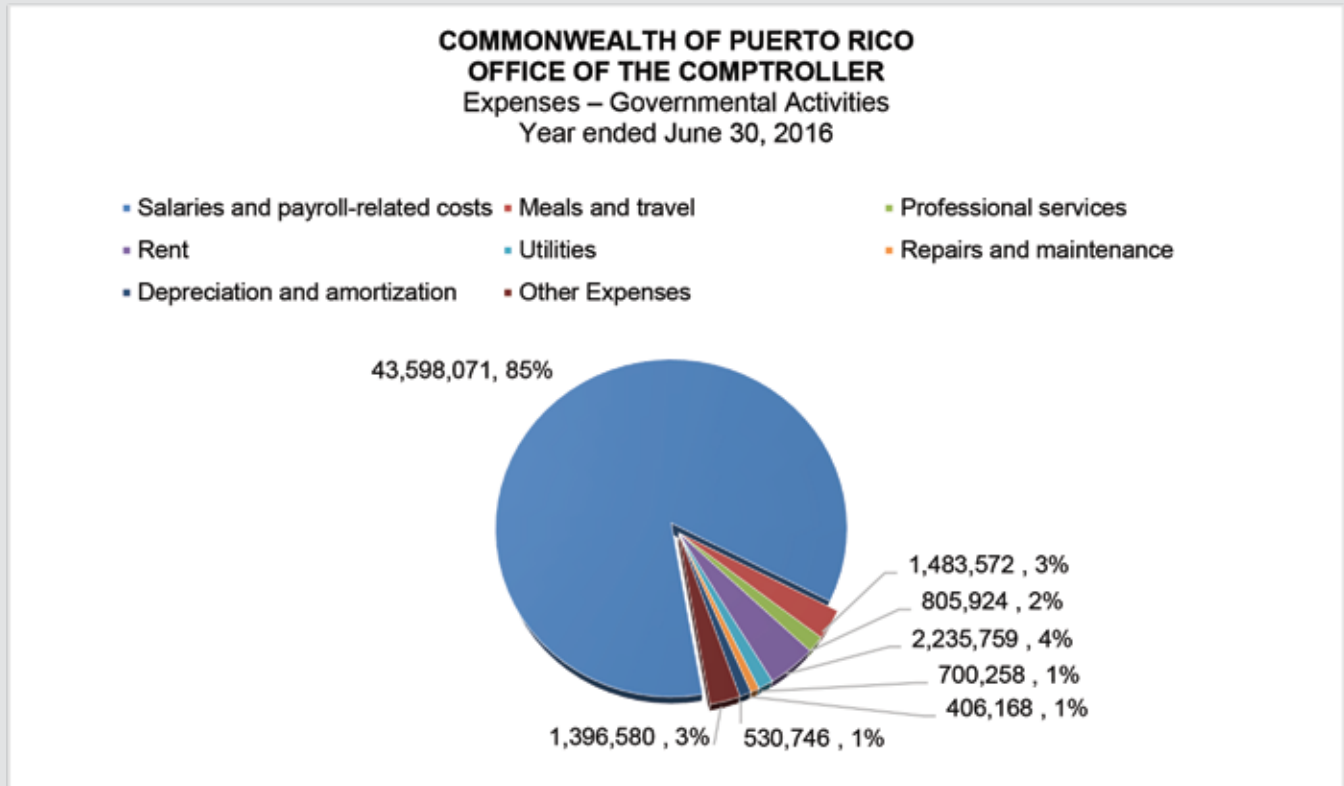
The following condensed summary of activities reflects how the Office's net position changed during the fiscal year ended June 30, 2016 compared to how the net position changed during the fiscal year ended June 30, 2015.

	<u>2016</u>	<u>2015</u>	<u>Change</u>
Revenues	\$ 11,616	7,445	4,171
Transfers in	40,894,112	41,292,643	(398,531)
Expenses	<u>(51,157,078)</u>	<u>(47,887,924)</u>	<u>(3,269,154)</u>
Change in net position	<u>\$ (10,251,350)</u>	<u>(6,587,836)</u>	<u>(3,663,514)</u>

(Continued)

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
 (An Agency of the Commonwealth of Puerto Rico)
 Management's Discussion and Analysis (Unaudited)
 June 30, 2016

The following chart presents the expenses incurred by the Office during the fiscal year ended June 30, 2016.



The Office's major expense is related to salaries, benefits, and payroll taxes, which represent 85% of total expenses incurred during fiscal year ended June 30, 2016. Total expenses also increased by approximately \$3,300,000 mainly due to pension costs incurred in 2016. The decrease in transfers in of approximately \$400,000 is mainly due to a decrease in the annual Legislative appropriations when compared to 2015.

General Fund Budgetary Highlights

The 2015-2016 General Fund Budget was \$39,690,000 and actual expenses in the budgetary basis were \$39,120,659. Total expenditures represented 98.5% of total budget availability for the fiscal year.

(Continued)

COMMONWEALTH OF PUERTO RICO
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(An Agency of the Commonwealth of Puerto Rico)
Management's Discussion and Analysis (Unaudited)
June 30, 2016

The following table summarizes the operational results under the non-GAAP budgetary basis of accounting for the fiscal year ended June 30, 2016.

	<u>Actual</u>
Revenue and other financing sources	\$ 39,701,617
Expenditures	<u>39,120,659</u>
Unexpended balance	<u>\$ 580,958</u>
Expenditure rate	98.5 %

The operational results present a saving on the assigned budget amounting to approximately \$580,000 for year ended 2016.

Economic Factors and Next Year's Budget

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

In addition, the Commonwealth also faces liquidity and debt payments issues. On June 30, 2016, the Governor signed executive order, EO-2016-030, declaring the Commonwealth to be in a state of emergency and declaring a moratorium on the Commonwealth's obligation to make payments on bonds and notes issued or guaranteed by the Commonwealth. Also on June 30, 2016, the U.S. President signed the Puerto Rico Oversight, Management, and economic Stability Act (PROMESA), which grants the Commonwealth and its component units access to an orderly mechanism to restructure their debts, in exchange for federal oversight over the Commonwealth's finances. In broad strokes PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt. The Commonwealth, in order to reduce its deficit, made a reduction on its general fund budget for 2017. As a result of this reduction, the Office approved budget for the fiscal year in 2017 is \$39,690,000. The Office adopted cost reduction measures that resulted in a decrease in certain employee benefits accrued in the government-wide financial statements.

Requests for Information

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

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
General Fund Balance Sheet and Statement of Net Position
June 30, 2016

	<u>General fund balance sheet</u>	<u>Adjustments</u>	<u>Statement of net position</u>
Assets:			
Cash in commercial bank	\$ 6,139,657	—	6,139,657
Accounts receivable – employees and other	30,472	—	30,472
Capital assets:			
Nondepreciable	—	38,355	38,355
Depreciable, net	—	1,563,169	1,563,169
Capital assets net	—	1,601,524	1,601,524
Total assets	6,170,129	1,601,524	7,771,653
Deferred outflows of resources	—	33,159,437	33,159,437
Total assets and deferred outflows of resources	\$ 6,170,129	34,760,961	40,931,090
Liabilities:			
Accounts payable and accrued liabilities	944,813	—	944,813
Other accrued long-term liabilities, due within one year	—	828,182	828,182
Other accrued long-term liabilities, due after one year	—	10,601,261	10,601,261
Net pension liability	—	169,692,545	169,692,545
Total liabilities	944,813	181,121,988	182,066,801
Deferred inflows of resources	—	2,943,533	2,943,533
Total liabilities and deferred inflows of resources	944,813	184,065,521	185,010,334
Fund balance/net position:			
Fund balance:			
Committed	374	(374)	—
Assigned	256,076	(256,076)	—
Unassigned	4,968,866	(4,968,866)	—
Total fund balance	5,225,316	(5,225,316)	—
Total liabilities and fund balance	\$ 6,170,129		
Net position:			
Net investment in capital assets		\$ 1,601,524	1,601,524
Unrestricted		(145,680,768)	(145,680,768)
Net position		\$ (144,079,244)	(144,079,244)

See accompanying notes to financial statements.

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

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

June 30, 2016

	General fund revenue, expenditures, and changes in fund balance	Adjustments	Statement of activities
Expenditures/expenses:			
General government:			
Salaries and payroll-related costs	\$ 33,447,881	10,150,190	43,598,071
Meals and travel	1,483,572	—	1,483,572
Professional services	805,924	—	805,924
Insurance	30,029	—	30,029
Rent	2,235,759	—	2,235,759
Utilities	700,258	—	700,258
Noncapitalizable equipment	25,199	—	25,199
Materials and supplies	66,765	—	66,765
Repairs and maintenance	406,168	—	406,168
Depreciation and amortization	—	530,746	530,746
Loss on disposition of assets	—	252,882	252,882
Trainings and continuing professional education	149,845	—	149,845
Subscriptions and memberships	124,425	—	124,425
Outsource services:			
Security	219,952	—	219,952
Maintenance	120,947	—	120,947
Other	334,433	—	334,433
Printing services	14,186	—	14,186
Postage	5,726	—	5,726
Impairment loss on deposits with governmental bank	14,011	—	14,011
Miscellaneous	38,180	—	38,180
Capital outlays	315,464	(315,464)	—
Total expenditures/expenses	<u>40,538,724</u>	<u>10,618,354</u>	<u>51,157,078</u>
General revenue – interest income	6,762	—	6,762
General revenue – miscellaneous income	4,854	—	4,854
Other financing sources – transfers in:			
Commonwealth of Puerto Rico appropriations	39,690,000	—	39,690,000
Other Commonwealth of Puerto Rico appropriations under Joint Resolution No. 63, of July 6, 2015	<u>1,204,112</u>	<u>—</u>	<u>1,204,112</u>
Total general revenue and transfers-in	<u>40,905,728</u>	<u>—</u>	<u>40,905,728</u>
Excess of revenues and transfers-in over expenditures	367,004	(367,004)	—
Change in net position	—	(10,251,350)	(10,251,350)
Fund balance/net position:			
At beginning of year	<u>4,858,312</u>	<u>(138,686,206)</u>	<u>(133,827,894)</u>
At end of year	<u>\$ 5,225,316</u>	<u>(149,304,560)</u>	<u>(144,079,244)</u>

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2016

(1) Organization and Basis of Presentation

(a) Organization

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

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

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

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

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

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

(b) The Financial Reporting Entity

The Office is an agency of the Commonwealth. Its financial statements are intended to present the financial position, and changes in financial position, of only that portion of the governmental activities and the General Fund of the Commonwealth that is attributable to the transactions of the Office.

(c) Basis of Presentation

The financial activities of the Office, which consist only of governmental activities, are reported under the general government function in the Commonwealth's basic financial statements. For its reporting

(Continued)

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

Notes to Financial Statements

June 30, 2016

purposes, the Office has combined the General Fund and government-wide financial statements using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. A brief description of the Office's government-wide and fund financial statements is as follows:

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

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

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

The following is a reconciliation between the General Fund balance sheet and the statement of net position at June 30, 2016:

Fund balance	\$ 5,225,316
Add capital assets, net of accumulated depreciation, as they are not financial resources and, therefore, are not reported in the General Fund	1,601,524
Add deferred outflows and inflows of resources related to pensions are applicable to future reporting periods and therefore, are not reported in the funds.	30,215,904
Less accrued compensated absences, net pension liability and Christmas bonus, as they are not due and payable in the current period and, therefore, are not reported in the General Fund	<u>(181,121,988)</u>
Net position	\$ <u>(144,079,244)</u>

(Continued)

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

Notes to Financial Statements

June 30, 2016

The following is a reconciliation between the excess of revenues and transfers in over expenditures in the statement of General Fund revenues, expenditures, and changes in fund balance, and the change in net position in the statement of activities for the fiscal year ended June 30, 2016:

Excess of revenues and transfers in over expenditures	\$ 367,004
Less current year change in compensated absences that are recorded as a long-term liability in the government-wide financial statements	(120,957)
Less current year change in accrued Christmas bonus that is recorded as a long-term liability in the government-wide financial statements	(239,475)
Less current year depreciation and amortization, as the cost of assets is allocated over their useful lives in the statement of activities	(530,746)
Less loss on disposal of assets that were not capitalized in the General Fund	(252,882)
Add pension contributions which are reported as expenditures in the governmental funds when made. However, they are reported as deferred outflows of resources in the statement of net position because the reported net pension liability is measured a year before the Office's report date	3,436,142
Less pension expense, which is the change in the net pension liability adjusted for changes in deferred outflows and inflows of resources related to pensions, is reported in the statement of activities	(13,225,900)
Add capital outlays reported as expenditures in the General Fund that are shown as capital assets in the statement of activities	<u>315,464</u>
Change in net position	<u>\$ (10,251,350)</u>

(d) Basis of Accounting

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

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

(Continued)

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

Notes to Financial Statements

June 30, 2016

(2) Going Concern – Commonwealth of Puerto Rico

As described in note 1 the Office is an agency of the Commonwealth. The Commonwealth and several of its component units face significant risks and uncertainties, including liquidity risk. The risks and uncertainties facing the Commonwealth, together with other factors, have led the Commonwealth's management to conclude that there is substantial doubt as to the ability of the primary government and of various discretely presented component units, to continue as a going concern. The financial difficulties being experienced by the Commonwealth have significant adverse impacts on the Office. Detailed information about the Commonwealth's conditions and events that arise doubt about its ability to continue as a going concern and the corresponding remediation plan is disclosed in the notes of the Commonwealth's 2016 year audited financial statements.

(3) Summary of Significant Accounting Policies

(a) Capital Assets

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

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

	<u>Years</u>
Electronic equipment	5
Other equipment	5
Furniture	10
Purchased computer software	5
Internally developed software	3–10
Vehicles	5–10

(b) Compensated Absences

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

(Continued)

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

Notes to Financial Statements

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The employees of the Office are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. Vacation may be accumulated in excess of the maximum permitted of sixty (60) and ninety (90) days, respectively. The employees have from January to June of each year to use any Vacation or Sick excess accumulated as of December of the previous year. If the employee chooses not to take the excess of Vacation and Sick during the assign period they will lose the excess accumulated. When an employee resigns, the Office accumulated vacation is liquidated. The resignation as a government employee, before consuming the accrued sick leave days, ends all rights to compensation except for those employees with ten (10) or more years of service, which have the right to such compensation up to the maximum allowed.

(c) *Deferred Outflows and Inflows of Resources*

In addition to assets, the Statement of Net Position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents an increase in of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. Similarly, the Office reports deferred inflows of resources in the Statement of Net Position in a separate section following Liabilities. This separate financial statement element, deferred inflows of resources, represents a reduction of net position and resources that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

(d) *Fund Balance*

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

- Fund balance is reported as nonspendable when the resources cannot be spent because they are either in a nonspendable form or legally or contractually required to be maintained intact. There was no nonspendable fund balance as of June 30, 2016.
- Fund balance is reported as restricted when the constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or imposed by law through constitutional provision or by enabling legislation. There was no restricted fund balance as of June 30, 2016.
- The Office's highest decision-making level of authority rests with the Commonwealth's Legislature. Fund balance is reported as committed when the Legislature passes a law that places specified constraints on how resources may be used. The law can modify or rescind a commitment of resources through passage of a new law.
- Resources that are constrained by the Office's intent to use them for a specific purpose, but are neither restricted nor committed, are reported as assigned fund balance. Intent may be expressed by the Comptroller.

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- Unassigned fund balance represents fund balance that has not been restricted, committed, or assigned and may be utilized by the Office for any purpose. When expenditures are incurred, and both restricted and unrestricted resources are available, it is the Office's policy to use restricted resources first, then unrestricted resources in the order of committed, assigned, and then unassigned, as they are needed.

(e) Net Position

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

- (i) Net investment in capital assets— This consists of capital assets, less accumulated depreciation and amortization.
- (ii) Restricted – This consists of net position that is legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is the Office's policy to use restricted resources first, then unrestricted resources when they are needed. There was no restricted net position at June 30, 2016.
- (iii) Unrestricted – This consists of net position that does not meet the definition of "restricted" or "net investment in capital assets."

(f) Commonwealth Appropriations

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

(g) Risk Management

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

The Office purchases commercial insurance to provide health benefits to its employees.

(h) Pensions

Financial reporting information pertaining to the Office participation in the Employee's Retirement System of the Government of Puerto Rico and its instrumentalities (ERS) is prepared in accordance with Governmental Accounting Standards Board ("GASB") Statement No. 68, *Accounting and Financial Reporting for Pensions*, as amended by GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the pension plans' fiduciary net position and additions to/deductions from the plans' fiduciary net position have been determined on the same basis as they are reported by the

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plans. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms.

(i) Use of Estimates

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

(j) Adoption of New Accounting Pronouncements

During the fiscal year ended June 30, 2016, the Office adopted the following new accounting standards issued by the GASB:

- (i) GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify – in the context of the current governmental financial reporting environment – the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The provisions of this Statement did not have a material impact on the Office.

(k) Accounting Pronouncements Issued but Not Yet Effective

The GASB has issued the following accounting standards that have effective dates after June 30, 2016:

- (i) GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for all postemployment benefits (pensions and OPEB) with regard to providing decision-useful information, supporting assessments of accountability and inter period equity, and creating additional transparency. This Statement replaces the requirements of Statements No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB. Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, establishes new accounting and financial reporting requirements for OPEB plans. The provisions of this Statement are effective for

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financial statements for periods beginning after June 15, 2017. The Office is currently evaluating the impact of this statement.

- (ii) GASB Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2019. The Office is currently evaluating the impact of this statement.
- (iii) GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. The Office is currently evaluating the impact of this statement.

(4) Deposits

The Office follows the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure*, an Amendment to GASB Statement No. 3. Accordingly, the following is essential information about the deposits of the Office at June 30, 2016:

Custodial credit risk is the risk that in the event of a bank failure, the Office's deposits may not be recovered. The Office's cash in commercial banks are deposited in the Banco Popular of Puerto Rico. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by banks in the Commonwealth's name.

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(5) Capital Assets

Capital assets activity for the year ended June 30, 2016 was as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Ending balance</u>
Capital assets, nondepreciable:				
Computer software being developed	\$ 154,801	67,082	(183,528)	38,355
Capital assets depreciable:				
Equipment	995,534	—	(57,976)	937,558
Electronic equipment	2,682,853	220,388	(172,560)	2,730,681
Furniture	1,121,285	26,222	(12,538)	1,134,969
Computer software	1,932,895	144,980	(305,803)	1,772,072
Vehicles	418,700	—	(49,995)	368,705
Total capital asset, depreciable	<u>7,151,267</u>	<u>391,590</u>	<u>(598,872)</u>	<u>6,943,985</u>
Less accumulated depreciation and amortization for:				
Equipment	824,696	58,820	(57,976)	825,540
Electronic equipment	2,193,013	229,984	(172,561)	2,250,436
Furniture	1,007,539	39,805	(11,586)	1,035,758
Computer software	879,221	189,120	(94,192)	974,149
Vehicles	331,911	13,017	(49,995)	294,933
Total accumulated depreciation and amortization	<u>5,236,380</u>	<u>530,746</u>	<u>(386,310)</u>	<u>5,380,816</u>
Total capital asset depreciable	<u>1,914,887</u>	<u>(139,156)</u>	<u>(212,562)</u>	<u>1,563,169</u>
Capital assets, net \$	<u><u>2,069,688</u></u>	<u><u>(72,074)</u></u>	<u><u>(396,090)</u></u>	<u><u>1,601,524</u></u>

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(6) Long-Term liabilities

Long-term liability activity for the year ended June 30, 2016 was as follows:

	<u>Beginning balance June 30, 2015</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance June 30, 2016</u>	<u>Due within one year</u>
Accrued compensated absences	\$ 10,671,936	5,541,359	(5,420,402)	10,792,893	191,632
Accrued Christmas bonus	397,075	636,550	(397,075)	636,550	636,550
Net pension liability	<u>146,917,907</u>	<u>28,030,435</u>	<u>(5,255,797)</u>	<u>169,692,545</u>	<u>—</u>
	<u>\$ 157,986,918</u>	<u>34,208,344</u>	<u>(11,073,274)</u>	<u>181,121,988</u>	<u>828,182</u>

(7) Lease Commitments

The Office rents its facilities through operating lease agreements in which the latest expires in 2018. Rent expense under such lease agreements for the year ended June 30, 2016 amounted to approximately \$2,225,000.

(8) Contingencies

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

(9) Pension Plan

(a) General Information about the Pension Plan

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

The ERS administers different benefit structures pursuant to Act No. 447, as amended, including a cost-sharing, multi-employer, defined benefit program, a defined contribution program (System 2000 program) and a contributory hybrid program. Benefit provisions may vary depending on a member's date of hire.

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The benefits provided to members of the ERS are established by Commonwealth law and may be amended only by Legislature with Governor's approval. Act No. 3 of April 4, 2013 (Act No. 3), in conjunction with other recent funding and design changes, provided for a comprehensive reform of the ERS. The Commonwealth does not guarantee benefits at retirement age.

Certain provisions are different for the three groups of members who entered the ERS prior to July 1, 2013 as described below:

- Members of Act No. 447 are generally those members hired before April 1, 1990.
- Members of Act No. 1 of February 16, 1990 (Act No. 1) are generally those members hired on or after April 1, 1990 and on or before December 31, 1999.
- Members of Act No. 305 of September 24, 1999 (Act No. 305 or System 2000) are generally those members hired on or after January 1, 2000 and on or before June 30, 2013.

All regular employees hired for the first time on or after July 1, 2013 and former employees who participated in the defined benefit program and the System 2000 program and were rehired on or after July 1, 2013 become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program are pooled and invested by the ERS. Future benefit payments will be paid from the same pool of assets.

Benefits Provided – An annuity payable for the lifetime of the member equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013. If the balance in the hybrid contribution account is \$10,000 or less, it shall be paid as a lump sum instead of as an annuity.

- 1) *Accrued Benefit as of June 30, 2013 for Act No. 447 Members* – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation, as defined, for Act No. 447 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 447 Mayors, the highest compensation, as defined, as a Mayor is determined as of June 30, 2013.

If the Act No. 447 member had at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting to coordinate with social security (the Coordination Plan), the benefit is re-calculated at the Social Security Retirement Age (SSRA), as defined, as 1.5% of average compensation up to \$6,600 multiplied by years of credited service, up to 30 years, plus 65% (75% if member was at least age 55 as of June 30, 2013) of average compensation in excess of \$6,600.

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If the Act No. 447 member had less than 30 years of credited service as of June 30, 2013, and attains 30 years of credited service by December 31, 2013, the accrued benefit equals 55% of average compensation if the member was under age 55 as of June 30, 2013 or 60% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting the Coordination Plan, the benefit is re-calculated at SSRA as 1.5% of average compensation up to \$6,600 multiplied by years of credited service, up to 30 years, plus 55% (60% if member was at least age 55 as of June 30, 2013) of average compensation in excess of \$6,600. Member contributions received from Act No. 447 members eligible for this transitory benefit during the period beginning July 1, 2013 and ending upon the attainment of 30 years of credited service are considered pre-July 1, 2013 contributions; the contributions to the hybrid contribution account begin after the member attains 30 years of credited service.

If the Act No. 447 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. Except for Commonwealth Police and Commonwealth Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58. For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to \$6,600 multiplied by years of credited service up to 20 years, plus 1.5% of average compensation up to \$6,600 multiplied by years of credited service in excess of 20 years, plus 1.5% of average compensation in excess of \$6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of \$6,600 multiplied by years of credited service in excess of 20 years. Except for Police and Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

For Act No. 447 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation, as defined, as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

- 2) **Accrued Benefit as of June 30, 2013 for Act No. 1 Members** – The accrued benefit as of June 30, 2013 shall be determined based on the average compensation for Act No. 1 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 1 Mayors, the highest compensation as a Mayor is determined as of June 30, 2013.

If the Act No. 1 member is a police officer or firefighter with at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013.

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For all other Act No. 1 members, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service. The benefit is actuarially reduced for each year payment commences prior to age 65.

Contributions

The contribution requirement to the ERS is established by Commonwealth law and is not actuarially determined. The following are the member and employer contributions:

1) *Member Contributions*

Effective July 1, 2013, contributions by members are 10% of compensation. However, for Act No. 447 members who selected the Coordination Plan, the member contributions are 7% of compensation up to \$6,600 plus 10% of compensation in excess of \$6,600 during the 2013-2014 fiscal year and 8.5% of compensation up to \$6,600 plus 10% of compensation in excess of \$6,600 during the 2014-2015 fiscal year. Members may voluntarily make additional contributions to their hybrid contribution account.

2) *Employer Contributions (Article 2-116, as Amended by Law No. 116 of 2010 and Act No. 3)*

Effective July 1, 2011, employer contributions are 9.275% of compensation. For the next four fiscal years effective July 1, employer contributions will increase annually by 1% of compensation. For the five fiscal years thereafter, employer contributions will increase annually by 1.25% of compensation, reaching an employer contribution rate of 20.525% of compensation effective July 1, 2020.

3) *Supplemental Contributions from the Commonwealth's General Fund, Certain Public Corporations, and Municipalities (Act No. 3)*

Effective July 1, 2013, the System will receive a supplemental contribution of \$2,000 (of which \$800 corresponds to the pension plan and \$1,200 corresponds to the post employment healthcare benefits plan) each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefitting as an Act No. 447 or Act No. 1 member while an active employee. This supplemental contribution will be paid by the Commonwealth's General Fund for former government and certain public corporations without their own treasuries employees or by certain public corporations with their own treasuries or municipalities for their former employees.

4) *Additional Uniform Contribution (Act No. 32, as Amended)*

The additional uniform contribution will be certified by the external actuary of the System each fiscal year from 2014-2015 through 2032-2033 as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, fall below \$1 billion. The additional uniform contribution is to be paid by the Commonwealth's General Fund, public corporations with their own treasuries, and municipalities. The additional uniform contribution determined for fiscal years 2014, 2015 and 2016 was \$120 million, payable at the end of each

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fiscal year. The additional uniform contribution determined for fiscal year 2016-2017 is \$596 million, payable at the end of the fiscal year.

Additional information for the ERS is provided in its financial statements for the year ended June 30, 2016 a copy of which can be obtained from the Administrator of the Retirement Systems of the Commonwealth of Puerto Rico, P.O. Box 42003, San Juan, Puerto Rico 00949.

(b) Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At June 30, 2016, the Office recorded a liability of \$169,692,545 for its proportionate share of the net pension liability. The net pension liability for the plan in total was measured as of June 30, 2015 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Office's proportionate share of the total net pension liability was based on the ratio of the Office's contributions of \$3,240,533 paid to ERS for the year ended June 30, 2015 relative to the total contributions for allocation of \$632,181,708 from all participating employers. At June 30, 2015, the Office's proportionate share was 0.51259%, which increased 0.02378% when compared with the proportionate share as of June 30, 2014 of 0.48881%.

For the year ended June 30, 2016, the Office recognized pension expense of \$13,225,900.

At June 30, 2016, the Office reported deferred outflows of resources and deferred inflows of resources from the following sources related to ERS pension benefits:

	<u>Deferred outflows of resources</u>	<u>Deferred inflows of resources</u>
Balance of deferred outflows and inflows due to:		
Difference between expected and actual experience	\$ 196,109	1,967,759
Changes of assumptions	16,153,672	—
Net difference between projected and actual earnings on pension plan investments	—	975,774
Changes in proportion and differences between employer contributions and proportionate share of contributions	13,373,514	—
Employer contributions subsequent to the measurement date	3,436,142	—
Total	<u>\$ 33,159,437</u>	<u>2,943,533</u>

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\$3,436,142 reported as deferred outflows of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction to the net pension liability in the year ended June 30, 2017. Other amounts reported as collective deferred (inflows)/outflows of resources to be recognized in pension expense as follows:

Year ending June 30:	
2017	\$ 5,246,582
2018	5,246,582
2019	5,246,582
2020	5,488,908
2021	5,551,108
Thereafter	—
	<u>\$ 26,779,762</u>

(c) Actuarial Assumptions

Actuarial valuations of ERS involves estimates of the reported amount and assumptions about probability of occurrence of events far into the future. Examples include assumptions about future employment mortality and future salary increases. Amounts determined regarding the net pension liability are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. Significant actuarial assumptions and other inputs used to measure the total pension liability:

Measurement date	June 30, 2015
Actuarial cost method	Entry age normal
Asset valuation method	Market value of assets
Inflation	2.50%
Future salary increases	3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66 and the current general economy.
Cost-of-living increases	None assumed.
Mortality assumption	Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for for males and females adjusted to reflect Mortality Improvement Scale MP-2015 from the 2006 base year, and projected forward using MP-2015 on generational basis. For members covered under Act 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for male and females adjusted to reflect Mortality Improvement Scale MP-2015 from 2006 base year, and projected forward using MP-2015 on generational basis. As generational tables, they reflect mortality improvements both before and after measurement date.

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Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from UP-1994 Mortality Tables for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As generational tables, they reflect mortality improvements both before and after measurement date.

Post-retirement Disabled Mortality: Rates which vary by gender are assumed for disabled retirees based on a study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2015 on a generational basis. As generational tables, they reflect mortality improvements both before and after measurement date.

(d) Changes in Assumptions

Actuarial assumptions are revised periodically to more closely reflect both actual and anticipated future experience.

The June 30, 2015 actuarial valuation for ERS reflects an increase of approximately \$2.4 billion in the total pension liability of which approximately \$12.5 million was allocated to the Office because of the changes in assumptions related to the change in the discount rate, and a decrease of approximately \$464 million in the total pension liability of which approximately \$2.4 million was allocated to the Office because of differences between expected and actual experience. With the enactment of Act No. 3 of 2013, termination, retirement and disability rates were added for new Act No. 3 members. Also, the compensation increase assumption was revised due to Act No. 66 of 2014.

For purposes of the 2017 actuarial valuation, the projected mortality improvement scale should be updated from Scale MP-2015 to Scale MP-2016, which was published by the Society of Actuaries in October 2016. Also, the 2017 valuation should reflect the impact of the salary growth assumption as a result of the Act No. 3-2017 extension of the Act No. 66-2014 salary freeze until July 1, 2021.

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(e) Long-Term Expected Rate of Return

The long-term expected rate of return on pension benefit investments was determined in accordance with the asset allocation portfolio that was adopted by the ERS Board during December 2013 and the actuary's capital market assumptions as of June 30, 2015. The long-term expected rate of return on pension benefit investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target asset allocation and estimates of expected rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2015 are summarized in the following table:

	<u>Target allocation</u>	<u>Long-term expected rate of return</u>
Asset class:		
Domestic equity	25 %	6.4 %
International equity	10	6.7
Fixed income	64	6.3
Cash	<u>1</u>	<u>3.0</u>
Total	<u><u>100 %</u></u>	

(f) Date of Depletion and Discount Rate

The asset basis for the depletion projection is the ERS fiduciary net position. On this basis, the ERS fiduciary net position was exhausted in fiscal year 2015. The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and in the event that their financial condition does not improve in the near term.

The ERS fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the tax free municipal bond index (Bond Buyer General Obligation 20 Bond Municipal Bond Index) was applied to all periods of projected benefit payments to determine the total pension liability. The discount rate used to measure the ERS total pension liability was 3.80%.

(Continued)

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

Notes to Financial Statements

June 30, 2016

(g) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Office as of June 30, 2016, calculated using the discount rate of 3.80%, as well as what the net pension liability would be if it was calculated using a discount rate that is 1-percentage point lower (2.80%) or 1-percentage point higher (4.80%) than current rate:

	<u>At 1% decrease (2.80%)</u>	<u>At current discount rate (3.80%)</u>	<u>At 1% increase (4.80%)</u>
Net pension liability	\$ 193,448,673	169,692,545	150,228,187

(10) General Fund – Fund Balance

At June 30, 2016, portions of the General Fund balances were committed and assigned for specific amounts as follows:

<u>Fund balance</u>	<u>Amount</u>
Committed:	
Repair of vehicles due to collision	\$ 374
Assigned:	
Purchased services	2,600
Professional services	<u>253,476</u>
	256,076
Unassigned	<u>4,968,866</u>
	<u>\$ 5,225,316</u>

(11) Subsequent Events

The Office has evaluated subsequent events from the General Fund balance sheet and Statement of Net Position date through February 19, 2019, the date that the financial statements were available to be issued.

REQUIRED SUPPLEMENTARY INFORMATION (UNAUDITED)

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

Required Supplementary Information (Unaudited)

Schedule of Employer's Share of Net Pension Liability and Related Ratios

June 30, 2016

	<u>2016*</u>	<u>2015*</u>
Employer's proportion of the net pension liability	0.50902 %	0.48881 %
Employer's proportionate share of the net pension liability	\$ 169,692,545	146,917,907
Employer's covered-employee payroll	24,397,683	24,175,133
Employer's proportionate share of the net pension liability as a percentage of its covered-employee payroll	695.53 %	607.72 %
Plan fiduciary net position as a percentage of the total pension liability	(2.05)%	0.27 %

Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

* The amounts presented have a measurement date of the previous fiscal year end.

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Required Supplementary Information (Unaudited)
Schedule of Employer's Contributions
June 30, 2016

<u>Date</u>	<u>Contractually required contribution</u>	<u>Contributions in relation to contractually required contribution</u>	<u>Contribution deficiency (excess)</u>	<u>Employer's covered employee payroll</u>	<u>Contributions as a % of covered employee payroll</u>
June 30, 2014	\$ 2,968,947	2,968,947	—	24,175,133	12.28 %
June 30, 2015	3,240,533	3,240,533	—	24,397,683	13.28
June 30, 2016	3,436,142	3,436,142	—	24,064,999	13.47

Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report.

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

Required Supplementary Information (Unaudited)

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

Year ended June 30, 2016

	<u>Original budget</u>	<u>Final budget</u>	<u>Actual amounts (budgetary basis)</u>	<u>Variance- favorable (unfavorable)</u>
Revenue:				
Miscellaneous income	\$ —	—	4,855	4,855
Interest income	—	—	6,762	6,762
	<u>—</u>	<u>—</u>	<u>11,617</u>	<u>11,617</u>
Expenditures:				
Salaries and payroll-related expenditures	32,595,047	32,412,047	32,284,705	127,342
Facilities and payments of public services	855,046	727,632	700,423	27,209
Purchased services	3,343,202	3,343,202	3,181,071	162,131
Transportation expenditures	1,500,958	1,500,958	1,430,430	70,528
Professional services	839,796	889,796	826,770	63,026
Other expenditures	202,000	228,000	202,721	25,279
Materials and supplies	326,951	326,951	242,974	83,977
Capital outlays	16,000	250,414	248,382	2,032
Announcements and media communications required by law	<u>11,000</u>	<u>11,000</u>	<u>3,183</u>	<u>7,817</u>
	<u>39,690,000</u>	<u>39,690,000</u>	<u>39,120,659</u>	<u>569,341</u>
Other financing sources – transfers in:				
Commonwealth appropriations	<u>39,690,000</u>	<u>39,690,000</u>	<u>39,690,000</u>	<u>—</u>
Excess of revenue and other financing sources over expenditures	\$ <u>—</u>	<u>—</u>	<u>580,958</u>	<u>580,958</u>

See accompanying independent auditors' report.

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Notes to Required Supplementary Information (Unaudited)
June 30, 2016

(1) Changes of Benefit Terms and Assumptions

For purposes of the 2016 actuarial valuation, the projected mortality improvement scale was updated from Scale AA to Scale MP-2015, which was published by the Society of Actuaries in October 2015. Also, as Scale MP-2015 is a two-dimensional mortality improvement scale, the base mortality rates for the post-retirement mortality assumption was set to the 2010 rates – the central year of the 2007 to 2012 ERS experience study upon which the rates were based.

The investment return assumption reflects a decrease from 6.75% per year to 6.55% per year. The 6.55% assumption reflects the asset allocation for the non-loan portion of the portfolio that was adopted by the ERS during December 31, 2013 and the capital market assumptions as of June 30, 2015. In addition, the assumption reflects that loans to members comprise approximately 20% of the portfolio and have an approximate return of 9.1% with no volatility.

Please note that this new interest rate assumption of 6.55% per year is equal to the highest debt service of the Pension Obligation Bonds of the ERS. The debt on the Pension Obligations Bonds ranges from 5.85% to 6.55%.

(2) Budgetary Control

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

- The Office prepares its annual budget and submits it to the Legislature of the Commonwealth of Puerto Rico for its approval.
- The budget is approved on the basis of a global assignment.
- The budget is approved on the basis of a global assignment. The budget is prepared using the modified accrual basis of accounting, except for encumbrances, as explained below.

The budgeted revenue presented in the Statement of Revenues, Expenditures, and Changes in Fund Balance – Budget and Actual – Non-GAAP Budgetary Basis, consisted of a Legislative Appropriation, for the year ended June 30, 2016 for operational appropriations of \$39,690,000.

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

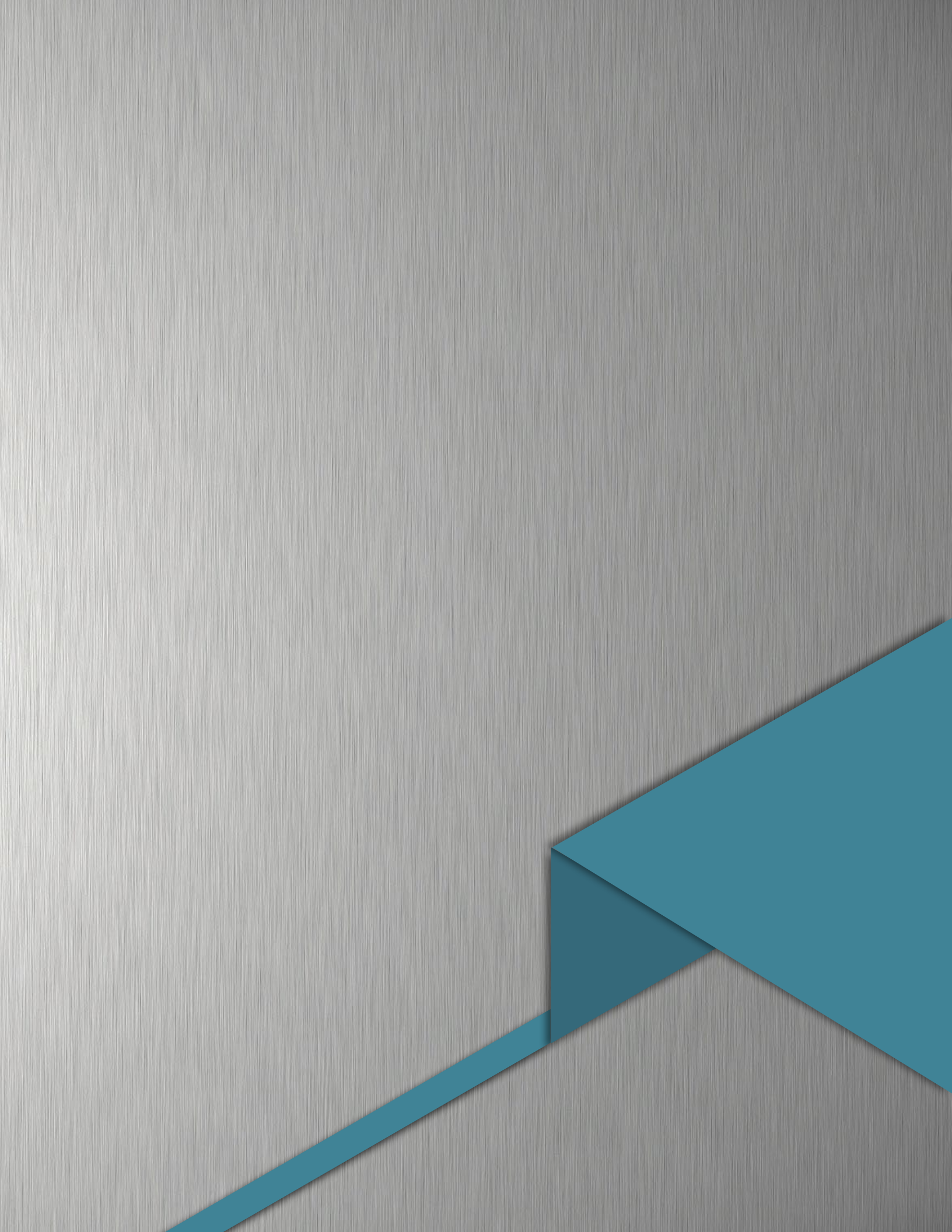
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COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMPTROLLER
(An Agency of the Commonwealth of Puerto Rico)
Notes to Required Supplementary Information (Unaudited)
June 30, 2016

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

Change in fund balance according to the statement of revenues, expenditures, and changes in fund balance – budget and actual non-GAAP budgetary basis – General Fund	\$ 580,958
Plus current year encumbrances not recorded as expenditures under the modified-accrual basis	256,076
Less expenditures recorded against unencumbered appropriations carried forward from prior year	(276,252)
Less prior year encumbrances recorded as expenditures under the modified accrual basis	<u>(193,778)</u>
Change in fund balance according to the statement of revenues, expenditures, and changes in fund balance – General Fund	\$ <u>367,004</u>

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





STATISTICAL SECTION

Chart 1 – Operations Budget

The table and chart that follow indicate the composition of the budget by salaries, transportation expenditures, professional services, and others, with respect to the total legislative appropriations. In addition, present a comparative picture for two consecutive fiscal years, 2015-16 and 2014-15.

DESCRIPTION	2015-16		2014-15	
	APPROPRIATION	PERCENT	APPROPRIATION	PERCENT
Salaries and Payroll Related Expenditures	\$32,412,047	81.7	\$32,484,899	80.5
Transportation Expenditures	1,500,958	3.8	1,633,608	4.0
Other Purchased Services	1,102,743	2.8	1,114,384	2.8
Professional Services	889,796	2.2	1,085,756	2.7
Facilities and Payments of Public Services	727,632	1.8	859,000	2.1
Rent	2,240,459	5.6	2,285,716	5.7
Materials and Supplies	326,951	0.8	404,090	1.0
Other Expenditures	239,000	0.6	224,300	0.6
Capital Outlays	250,414	0.7	223,247	0.6
Total	\$39,690,000	100	\$40,315,000	100

Chart 2 – Human Capital

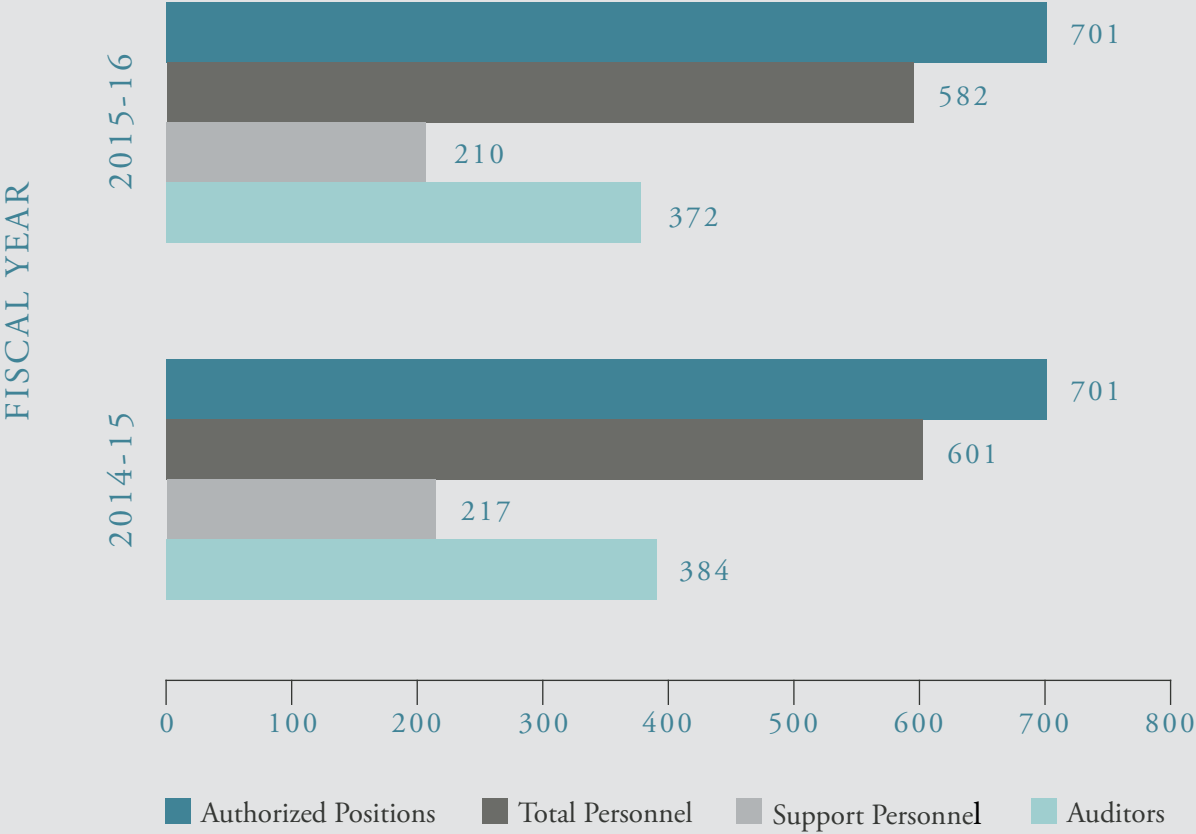


Chart 3 – Time Distribution

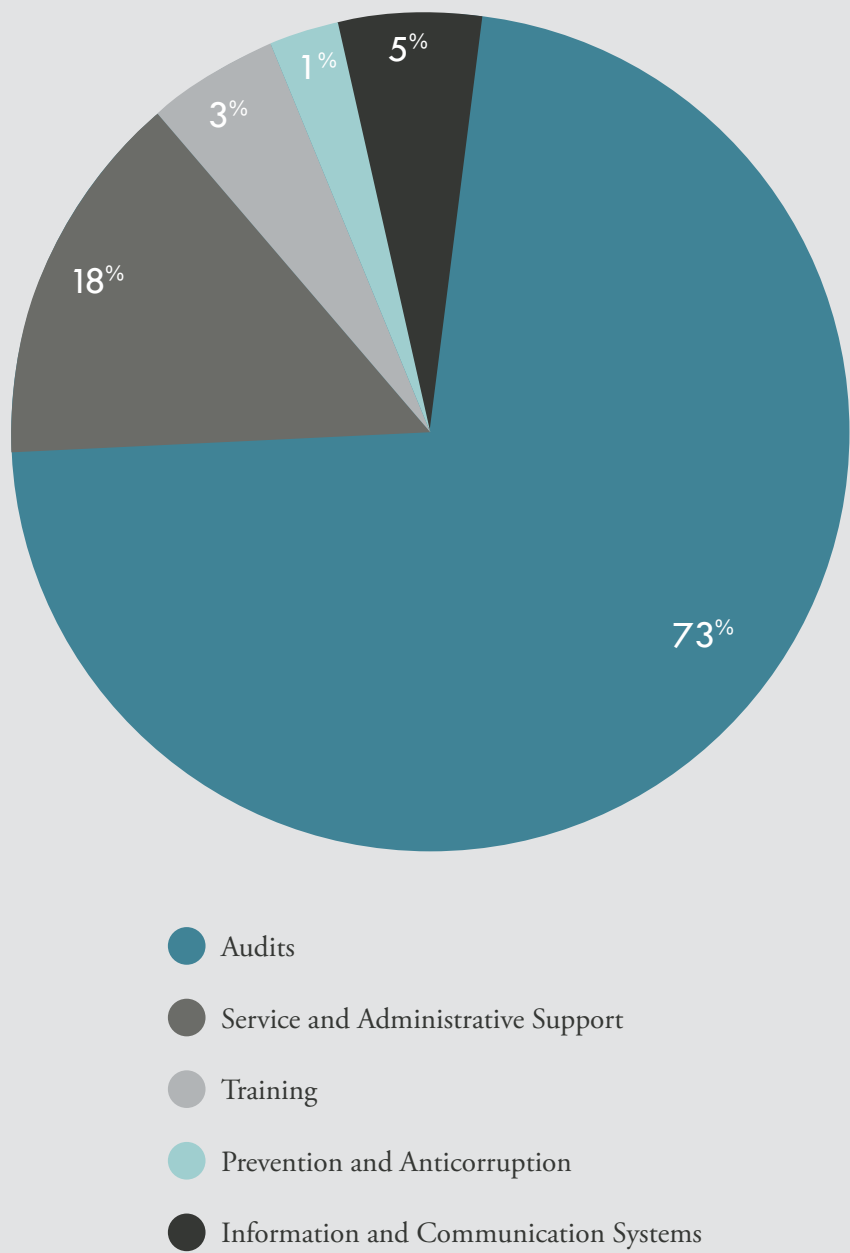


Chart 4 – Most Important Findings Included In Audit Reports

CLASSIFICATION	QUANTITY
Purchasing, accounts payable and disbursements	640
Planning-Administrative controls	632
Building and improvements	348
Cash	381
Professional services	122
Property	102
Revenues and receivables	86
Personnel	67
Donations	54
Applications controls	30
General controls - Computers	25
Privatizations	25
Investments	15
Others	8

IMPROVING

THE OVERSIGHT FUNCTION
AND ADMINISTRATION OF
PUBLIC FUNDS AND PROPERTY
IS A COMMITMENT OF ALL.

Comptrollership At Your Services...

INTERNAL ANTICORRUPTION POLICY



STATEMENT POLICY

The Office of the Comptroller of Puerto Rico is highly committed to combat corruption and fraud in the government and internally.

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 for Corruption has been established through this policy.

INTERNAL CONTROL POLICY

- Code of Ethics
- Code of Behavior
- Regulations
- Procedures
- Standards for the safety of our computerized systems
- Standards for confidentiality of the Office information and processes
- Annual renewal of constitutional commitment
- Annual certification of profitable activities and of filing Income Tax Returns.

PREVENTION PHASE

Recruiting: The recruiting of personnel must comply with the regulations and procedures approved by the Comptroller.

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

Internal Controls: The managerial personnel is responsible for monitoring that the controls established in their respective working areas are effective, efficient, and updated. Our internal auditors periodically 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 promote and assure a sound public administration, as follows:

- The Advisory Committee on Internal Audit can require audits of the Office and have access to all accounting files.
- External Auditors shall not be contracted for more than three consecutive years.
- Regulations and policies for suppliers of property or services were approved to regulate relations between the Office and providers.
- Office of Government Ethics of Puerto Rico (OGEPR), the Comptroller and designated personnel file financial reports with OGEPR.

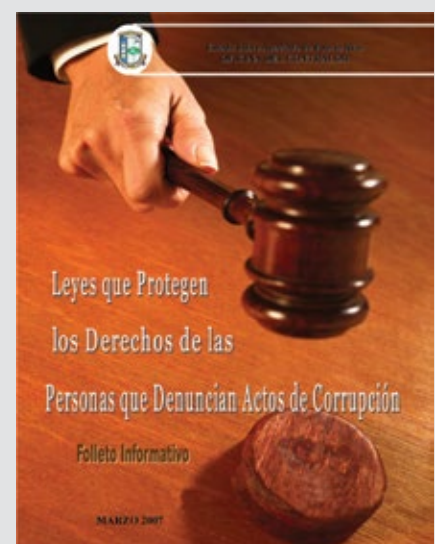
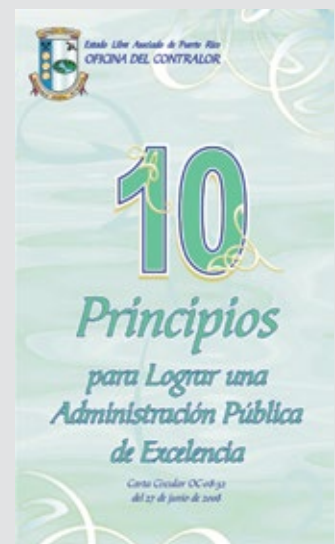
CONFIDENTIALITY

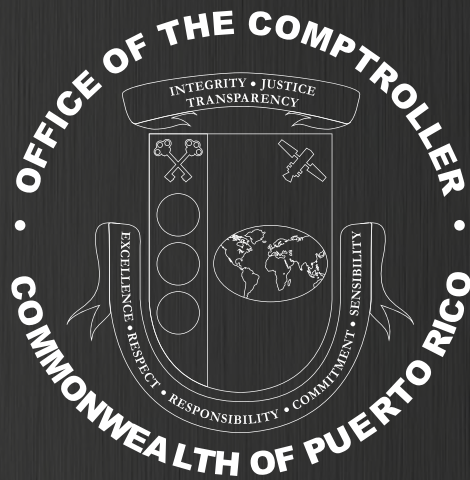
Acts No. 426 of November 7, 2000 and No. 14 of April 11, 2001, provide protection and prohibit disclosure of public employees and officials, complainants or witnesses for reporting alleged illegal acts or corruption actions.

CONTINUOUS EDUCATION

We established a policy that requires 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 standards, and procedures, among others.

REFERENCE GUIDES PUBLISHED





COMPTROLLERSHIP AT YOUR SERVICES...