COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF HOUSING

FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION

FOR THE FISCAL YEAR ENDED JUNE 30, 2019

(WITH THE ADDITIONAL REPORTS REQUIRED BY THE GOVERNMENT AUDITING STANDARDS AND UNIFORM GUIDANCE)

CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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PART I

FINANCIAL

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

Honorable Secretary of the
Department of Housing of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Department of Housing of the Commonwealth of Puerto Rico (PRDH)**, as of and for the fiscal year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise **PRDH**'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 accounting principles generally accepted in the United States of America; 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.

Auditor's 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 of 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 auditor's 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 **PRDH**'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 the 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 our audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions Plan and Other Postemployment Benefits Plan

We were unable to obtain sufficient appropriate audit evidence about the deferred outflows/inflows of resources, liabilities, and expenses related to pension and other postemployment benefits of the governmental activities and disclosures in the accompanying notes. As discussed in Notes M and O to the financial statements, the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (PRERS) has not issued audited financial statements as of and for the Fiscal Year ended June 30, 2018 nor has provided to the **PRDH** the required information to record transactions related to pension and other postemployment benefits as of and for the Fiscal Year ended June 30, 2019. Amounts reported in the government-wide financial statements as deferred outflows of resources, deferred inflows of resources, net pension liability, and net other postemployment benefits liability were derived from the application of the proportional share included in the audited Schedules of Employer Allocations, and Schedules of Employer Allocations and Schedules of OPEB Amounts by Employer, published by the PRERS, cost-sharing multiple-employer pension plan for the Fiscal Year ended June 30, 2017. Accordingly, the **PRDH**' did not record the current pension expense, changes in deferred outflows/inflows of resources, net pension liability, net other postemployment benefits liability, and additional disclosures, and supplementary information required by generally accepted accounting principles for pension and other postemployment benefits as of and for the Fiscal Year ended June 30, 2019. The amounts by which this situation would affect the presented liabilities, deferred outflows of resources, deferred inflows of resources, net position, and expenses has not been determined.

Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions Plan and Other Postemployment Benefits Plan

In our opinion, except for the possible effects of the matter described above in the "*Basis for Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions Plan and Other Postemployment Benefits Plan"* paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the **PRDH** as of June 30, 2019 and the respective changes in financial position thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major funds, and the aggregate remaining fund information of the **PRDH**, as of June 30, 2019, and the respected changes in the financial position and, where applicable, cash flows thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note A, the financial statements of **PRDH** are intended to present the financial position and the changes in financial position of only that portion of the governmental activities of the financial reporting entity of the Commonwealth of Puerto Rico that is attributable to the transactions of **PRDH**. They do not purport to, and do not, present fairly the financial position of the Commonwealth of Puerto Rico as of June 30, 2019, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Uncertainty about Ability to Continue as a Going Concern – Primary Government

PRDH is part of the Commonwealth of Puerto Rico (Commonwealth). The accompanying financial statement of **PRDH** have been prepared assuming that the Commonwealth will continue as a going concern. As discussed in Note T on pages 80-81 to the financial statements, the Commonwealth's recurring deficits, negative financial position, further deterioration of its economic condition, and inability to access the credit markets raises substantial doubt about the Commonwealth's ability to continue as a going concern. Management's plans regarding these matters are also described in Note T. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinions are not modified with respect to this matter.

Restatement of Prior Year Financial Statements

As discussed in Note C to the financial statements, the 2018 financial statements have been restated to adjust and/or recognized net pension liability, net other postemployment liability, and deferred outflows/inflows of resources. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, on pages 6-18, budgetary comparison information, on pages 118-119, and employees' retirement systems information, 120 through 123 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 related to management's discussion and analysis, and budgetary comparison 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. We were unable to apply certain limited procedures to the required supplementary information related to employees' retirement systems information applicable to **PRDH**, in accordance with auditing standards generally accepted in the United States of America. We do not express an opinion or provide any assurance on the information.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **PRDH**'s basic financial statements. The accompanying Financial Data Schedules – Section 8 Housing Choice Vouchers Program, as required by U.S. Department of Housing and Urban Development, on pages 125 through 128, and the Schedule of Expenditures of Federal Awards, as required by *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Award,* on pages 130 through 132, is presented for purposes of additional analysis and is not required part of the basic financial statements.

The Financial Data Schedule – Section 8 Housing Choice Vouchers Program and the Schedule of Expenditures of Federal Awards are the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Financial Data Schedule – Section 8 Housing Choice Vouchers Program and the Schedule of Expenditures of Federal Awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

Other Reporting Required by *Governmental Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 14, 2021 on our consideration of **PRDH**'s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering **PRDH**'s internal control over financial reporting and compliance.

CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2022

Caguas, Puerto Rico
April 14, 2021

Stamp No. E438142 of the Puerto Rico Society of Certified
Public Accountants was affixed to the original report.

As management of the Department of Housing of the Commonwealth of Puerto Rico (hereafter the PRDH), we offer readers of the PRDH's financial statements this narrative overview and analysis of the financial activities of the PRDH for the fiscal year ended June 30, 2019. We encourage readers to read the information presented here in conjunction with the basic financial statements.

FINANCIAL HIGHLIGHTS

- Total assets decreased from $543.6 million in fiscal year 2018 to $526 million on June 30, 2019, representing a decrease of approximately $17.6 million or 3% in comparison with prior year. This net decrease is mainly due to the net effect of a reduction of approximately $138.6 million in the accounts receivable related to Federal programs, and the increases on cash by approximately $111 million related to the Sheltering and Temporary Essential Power (STEP) Pilot Program, and approximately $11.4 million in the Note Receivable from Developer.

- Total liabilities decreased from $442 million in fiscal year 2018 to $425.9 million on June 30, 2019, representing a decrease of approximately $16 million or -4% in comparison with prior year.

- Prior period adjustments of $9,851,139 resulted from adjustments to the PRDH's pension and OPEB obligations and its related deferrals by the implementation of the GASB's Statements No. 68 and No. 75, respectively, with audited schedules as of June 30, 2018 issued by the Puerto Rico Retirement System Administration.

- Net position remained in line with prior year as it only decreased by approximately $703 thousand or 1% in comparison with prior year.

- The change in net position amounted to approximately ($703) thousand and ($69) thousand for the years ended June 30, 2019 and 2018, respectively, a variance of approximately $634 thousand or 917% when compared to prior year.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the PRDH's basic financial statements. The PRDH's basic financial statements consist of three components; 1) government-wide financial statements, 2) fund financial statements, 3) notes to the basic financial statements and 4) required supplementary information (see Figure 1). The basic financial statements present two different views of the PRDH through the use of government-wide statements and fund financial statements. In addition to the basic financial statements, this report contains other supplemental information that will enhance the reader's understanding of the financial condition of the PRDH.

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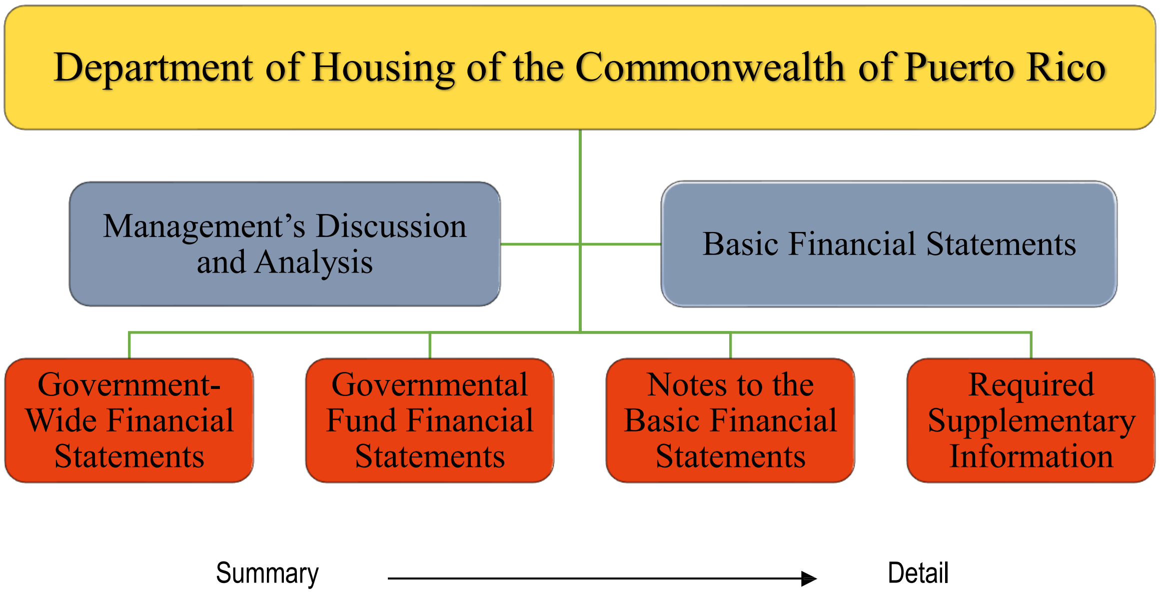
Figure 1

Required Components of Annual Financial Report



Basic Financial Statements

The first statements in the basic financial statements are the **Government-wide Financial Statements**. They provide both short and long-term information about the PRDH's financial status.

The next statements are the **Fund Financial Statements**. These statements focus on the activities of the individual parts of the PRDH's government. These statements provide more details than the government-wide financial statements.

The next section of the basic financial statements is the **Notes to the Financial Statements**. The notes to the financial statements explain in detail some of the data contained in those statements.

Both financial statements present the governmental activities of the PRDH. The government-wide and fund financial statements can be found immediately following this discussion and analysis.

New Significant Accounting Standards

The Governmental Accounting Standards Board issued the GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance* that is effective immediately. The PRDH is currently evaluating its accounting practices to determine the potential impact on the financial statements for the future pronouncements.

The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

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The effective dates of certain provisions contained in the following pronouncements are postponed by one year:

- Statement No. 83, *Certain Asset Retirement Obligations*
- Statement No. 84, *Fiduciary Activities*
- Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
- Statement No. 90, *Majority Equity Interests*
- Statement No. 91, *Conduit Debt Obligations*
- Statement No. 92, *Omnibus 2020*
- Statement No. 93, *Replacement of Interbank Offered Rates*
- Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan reporting)*
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*
- Implementation Guide No. 2019-1, *Implementation Guidance Update—2019*
- Implementation guide No. 2019-2, *Fiduciary Activities*

The effective dates of the following pronouncements are postponed by 18 months:

- Statement No. 87, *Leases*
- Implementation Guide No. 2019-3, *Leases*.

Earlier application of the provisions addressed in this Statement is encouraged and is permitted to the extent specified in *each* pronouncement as originally issued.

Government-Wide Financial Statements

The government-wide financial statements provide a broad view of the PRDH's operations in a manner similar to a private sector business. The financial statements provide both short and long-term information about the PRDH's financial position, which assists the PRDH in assessing the PRDH's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. This basically means they follow methods that are similar to those used by most businesses. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid. The government-wide financial statements include two statements:

- The *Statement of Net Position* presents information on all of the PRDH's assets, plus deferred outflows of resources less liabilities, plus deferred inflows of resources with the difference reported as net position. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the PRDH is improving or deteriorating.

- The *Statement of Activities* presents information showing how the PRDH'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 result in cash flows in future fiscal periods (e.g., earned but unused vacation leave). This statement also presents a comparison between direct expenses and program revenue for each function of the PRDH.

The basic government-wide financial statements can be found on pages 19 through 21.

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Governmental 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 PRDH, like other local governments, uses fund accounting to ensure and demonstrate compliance with finance – related legal requirements. The fund financial statements focus on individual parts of the PRDH governmental funds, reporting the PRDH's operations in more detail in the government-wide financial statements. All of the funds of the PRDH can be divided into three categories. It is important to note that these fund categories use different accounting approaches and should be interpreted differently. The three categories of funds are the following:

Governmental Funds – Governmental funds are used to account for essentially the same activities reported in the government-wide financial statements. However, unlike the government-wide financial statements, the governmental fund financial statements focus on near term inflows and outflows of expendable resources.

They also focus on the balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating the governments near term financing requirements. This approach is known as using the flow of current financial resources measurement focus and the modified accrual basis of accounting. These statements provide a detailed short-term view of the PRDH's finances that assists in determining whether there will be adequate financial resources available to meet the current needs of the PRDH. Because the focus of the governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental fund with similar information presented for governmental activities in the government-wide financial statements.

By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between governmental fund and the governmental activities. These reconciliations are presented on the page immediately following each governmental fund financial statement.

The Governmental Fund Financial Statements include one column for the General Fund, one column for each major fund, and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, which is a percentage of the assets plus deferred outflows of resources, liabilities plus deferred inflows of resources, revenues or expenditures, and in addition, based on Management's criteria. PRDH reports major governmental funds as follows:

- *General Fund* – The general fund accounts for all resources except those required to be accounted for in other funds.

- *Section 8 Housing Choice Voucher Program Fund* – This major fund accounts for grants received from HUD. The Grant is restricted for accomplishing objectives of the Housing Voucher Program, which provides rental assistance to help very low-income families afford decent, safe and sanitary rental housing.

- *FEMA Recovery Fund* – This major fund accounts for grants received from Federal Emergency Management Administration (FEMA) through the Sheltering and Temporary Essential Power (STEP) Pilot Program. The grant is restricted for providing minor emergency repairs to single-family owner-occupied residences.

- *CDBG Fund* - This major fund accounts for grants received from HUD. The grant is restricted for the Community Development Block Grant program. This program provides annual grants to municipalities to develop viable urban communities by providing decent housing and a suitable living environment, and by expanding economic opportunities, principally for low- and moderate-income persons.

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- *CDBG-DR Fund* - This major fund accounts for grants received from HUD. The grant is restricted for the Community Development Block Grant Disaster Recovery Program. This program provides grants to rebuild areas affected by Presidentially declared disasters and provide crucial seed money to start the recovery process. Since CDBG Disaster Recovery (CDBG-DR) assistance may fund a broad range of recovery activities, it is designed to communities and neighborhoods that otherwise might not recover due to limited resources.

- *Self-Contribution Fund* – This fund is maintained by the PRDH to account for current financial resources received from proceeds of sale and rent of land lots, indirect costs, fees for elderly care and other revenues collected from sources other than intergovernmental or federal subsidies. Also, it includes the resources and expenditures received and used respectively for the improvement of the PRDH's main building.

- *Sales and Acquisition Fund* – This fund is maintained by the PRDH to account for current financial resources received to liquidate the assets of the former Puerto Rico Urban Renewal and Housing Corporation (PRURHC) and to meet its financial obligations with the proceeds to sales.

- *Other Governmental Funds* – Accounts for and reports other financial resources not included in the General Fund or the Special Revenue Fund.

The basic governmental funds financial statements can be found immediately following the government-wide financial statements (pages 22 through 25).

Fiduciary Fund Financial Statements: Fiduciary funds are not reflected in the government-wide financial statements because the resources of these funds are not available to support the PRDH's own activities. The accounting used for fiduciary funds is the accrual basis of accounting and presents the following funds:

- *Ponce en Marcha Fund* – By Law No. 206 of August 28, 2003, the Department of Justice of the Commonwealth of Puerto Rico obtained a line of credit of $90 million with the purpose of complying with a judicial settlement in the case of the Municipality of Ponce vs. the Puerto Rico Highway Authority and others. In relation with such settlement, the PRDH is the fiscal agent of the funds for planning and development of several Municipality of Ponce projects. The restricted cash balance is $336,751 on June 30, 2019 and is presented in the Statement of Fiduciary Net Position.

- *Special Communities Fund* – The PRDH is responsible for receiving and distributing funds assigned by the Perpetual Trust Fund for Special Communities for the Development Program (the Program). The Program established by Act No. 271 of November 21, 2012 and is funded through legislative appropriation and other grants. Program funds are distributed to the service providers based on the contracts made with the Perpetual Trust Fund for Special Communities. The restricted cash balance is $24,947 on June 30, 2019, is presented in the Statement of Fiduciary Net Position.

- *Remedy Fund* - The Municipality of Juncos established and funded a trust fund for the purpose of implementing the two remedies selected by the U.S. Environmental Protection Agency (EPA) for the old Juncos Landfill Superfund site as set forth in the EPA "Decision Summary" documents dated September 24, 1991, and October 5, 1993, as amended by EPA, to correct environmental damage left by the old Juncos Landfill. As part of these remedies the PRDH was appointed as the administrator agent of the Remedy Fund. As part of the settlement agreement, the PRDH established a $1.5 million Remedy Fund for construction. The restricted cash balance is $1,051,775 on June 30, 2019 and is presented in the Statement of Fiduciary Net Position.

The Statement of Fiduciary Net Position can be found immediately following the governmental fund financial statements (page 26).

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Notes to the 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 immediately following fund financial statements (pages 27 through 116).

Required Supplementary Information – Budgetary Comparison

Provides additional information to better understand the financial position of the PRDH and contains the Budgetary Comparison Schedule for the General Fund, are presented immediately following the notes to the financial statements and can be found on pages 118-119 of this report.

Required Supplementary Information

The required supplementary information reported are related to the implementation of GASB Statement No. 68 and GASB Statement No. 71 for pension liability reporting, are presented immediately following the notes to the financial statements and can be found on pages 120 through 123 of this report.

1. Government-wide Financial Analysis Statement of Net Position

- Total assets decreased from $543.6 million in fiscal year 2018 to $526 million on June 30, 2019, representing a decrease of approximately $17.6 million or 3% in comparison with prior year. This net decrease is mainly due to the net effect of a reduction of approximately $138.6 million in the accounts receivable related to the Sheltering and Temporary Essential Power (STEP) and the CDBG programs, and the increases on cash by approximately $111 million related to STEP and approximately $11.4 million in the Note Receivable from Developer.

- Total liabilities decreased from $442 million in fiscal year 2018 to $426 million on June 30, 2019, representing a decrease of approximately $16 million or -4% in comparison with prior year. Within liabilities, there is a decrease of $69 million in the amount due to the Puerto Rico Treasury Department and an increase of approximately $55.5 million related to accounts payable, mostly related to amounts owed to contractors of the STEP program and a decrease of $3 million in the long-term debts due to the 2019 amortization.

- Out of the $91.8 million in net position, $28.1 million are invested in capital assets, $9.5 million are restricted for specific program initiatives and $54.1 million are unrestricted on the use. Net position remained in line with prior year as it only decreased by approximately $703 thousand or 1% in comparison with prior year.

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1. Government-wide Financial Analysis Statement of Net Position (continued)

	2019	2018	Change	Percent
ASSETS				
Current Assets				
Cash and Cash Equivalents	$ 138,396,348	$ 30,427,713	$ 107,968,635	355%
Certificate of Deposit	195,050	-	195,050	-
Interest Receivable on Note	2,720,399	2,326,995	393,404	17%
Other Accounts Receivable				
Grants Receivable	164,144,855	302,698,614	(138,553,759)	-46%
Other State Funds Receivable	9,116,123	4,647,663	4,468,460	96%
Prepaid and Other Assets	515,470	687,345	(171,875)	-25%
Total Current Assets	315,088,245	340,788,330	(25,700,085)	-8%
Capital Assets				
Furniture, Equipment and Vehicles	6,645,161	6,202,599	442,562	7%
Parking and Building	5,164,129	5,164,129	-	0%
Building	30,000,000	30,000,000	-	0%
Building Improvements	21,525,268	21,525,268	-	0%
Less Accumulated Depreciation	(27,403,207)	(25,259,368)	(2,143,839)	8%
	35,931,351	37,632,628	(1,701,277)	-5%
Capital Assets Not Being Depreciated:				
Land	850,831	850,831	-	0%
Construction in Progress	339,924	-	339,924	0%
	1,190,755	850,831	339,924	
Total Capital Assets	37,122,106	38,483,459	(1,361,353)	-4%
Other Noncurrent Assets				
Note Receivable from Related Entity, Noncurrent Portion	8,754,831	8,754,831	-	0%
Notes Receivable from Developer	39,733,679	28,340,792	11,392,887	40%
Due from Related Entity, Noncurrent Portion	72,522,474	72,895,921	(373,447)	-1%
Housing Units and Land Lots Held for Sale	33,598,468	35,121,585	(1,523,117)	-4%
Restricted Land Lot	19,200,000	19,200,000	-	0%
Capital Assets, Net	-	-	-	0%
Total Other Noncurrent Assets	173,809,452	164,313,129	9,496,323	6%
Total Assets	**$ 526,019,803**	**$ 543,584,918**	**$ (17,565,115)**	**-3%**
Deferred Outflows of Resources	**$ 9,597,059**	**$ 8,780,619**	**$ 816,440**	**9%**

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1. Government-wide Financial Analysis Statement of Net Position (continued):

	2019	2018	Change	Percent
LIABILITIES				
Current Liabilities				
Acounts Payable	$ 277,052,769	$ 235,388,204	$ 41,664,565	18%
Cash Overdraft	813,962	-	813,962	-
Due to Other Governmental Entities	829,284	69,870,766	(69,041,482)	-99%
Notes Payable, Current Portion	11,127,393	10,280,283	847,110	8%
Accrued Legal Claims, Current Portion	-	49,484	(49,484)	-100%
Accrued Compensated Absences, Current Portion	124,713	124,713	-	0%
Accrued Termination Benefits, Current Portion	836,126	893,136	(57,010)	-6%
Total Current Liabilities	290,784,247	316,606,586	(25,822,339)	-8%
Noncurrent Liabilities				
Accounts Payable	43,977,565	30,164,635	13,812,930	46%
Note Payable, Long-Term Portion	9,660,560	13,502,380	(3,841,820)	-28%
Accrued Legal Claims, Long-Term Portion	3,280,284	3,230,800	49,484	2%
Accrued Compensated Absences, Long Term Portion	1,334,715	1,142,193	192,522	17%
Accrued Termination Benefits, Long Term Portion	3,639,952	4,075,952	(436,000)	-11%
Net Pension Liability	66,822,303	66,822,303	-	0%
Other Postemployment Benefit Obligation	6,439,762	6,439,762	-	0%
Total Noncurrent Liabilities	135,155,141	125,378,025	9,777,116	8%
Total Liabilities	**425,939,388**	**441,984,611**	**(16,045,223)**	**-4%**
Deferred Inflows of Resources	**17,904,763**	**17,904,763**	**-**	**0%**
Net Position				
Net Investment in Capital Assets	28,145,863	28,129,883	15,980	0%
Restricted	9,534,794	7,882,408	1,652,386	21%
Unrestricted	54,092,054	56,463,872	(2,371,818)	-4%
Total Net Position	**$ 91,772,711**	**$ 92,476,163**	**$ (703,452)**	**-1%**

2. Government-Wide Financial Analysis Statement of Activities

- Total net expenses from governmental activities decreased from approximately $4.1 million in fiscal year 2018 to approximately $1.2 million in the fiscal year 2019, representing a decrease in net expenses of approximately $2.8 million (after consideration of prior period adjustment). Within the governmental activities, the net expenses from general, administrative and other activities increased from approximately $6.1 million to approximately $15 million. On the other hand, the net expenses in construction and rehabilitation activities decreased from approximately $4.4 million in 2018 to approximately $89 thousand in 2019. Additionally, the net revenue from tenant, utility services and maintenance activities increased from approximately $5.3 million to approximately $13.2 million.

- The general revenues remained in line with those of fiscal year 2018 as it only decreased by approximately $117 thousand in 2019, or 5%. This decrease is mostly driven by a decrease in interest and investment income from a mixed finance project. For the transfers and special items, the fair market value adjustment in housing units and lots held for sale decrease by approximately $3.5 million from the balance adjusted in fiscal year 2018.

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2. Government-wide Financial Analysis Statement of Activities (continued):

- There were prior period adjustments in 2019 reducing the Net Position by approximately $9.9 million for which $3.4 million is related to an adjustment to the net pension liability and the related deferrals, and additionally, the recognition of the OPEB obligations by approximately $6.5 million.

For the year ended June 30, 2019 net position changed as follows:

Net (Expenses) Revenues and Changes in Net Position

Figure 1

	Changes in Net Position			
	2019	**2018**	**Change**	**Percent**
Governmental Activities:				
Function/Program				
General, Administrative	$ (15,303,645)	$ (6,055,499)	$ (9,248,146)	153%
Construction and Rehabilitation	(88,514)	(4,378,011)	4,289,497	-98%
Housing Sales and Adjustments	1,522,178	1,555,009	(32,831)	-2%
Tenants, Utility Services and Maintenance	13,219,667	5,321,380	7,898,287	148%
Interest Expenses	(587,021)	(504,043)	(82,978)	16%
Total Governmental Activities	(1,237,335)	(4,061,164)	2,823,829	-70%
General Revenues:				
Management and Developer Fees	153,555	82,083	71,472	87%
Interest and Investment Income	1,923,445	2,111,570	(188,125)	-9%
Total General Revenues	2,077,000	2,193,653	(116,653)	-5%
Transfers and Special Items:				
Net Transfers to Other Agencies/Entities	(20,000)	(194,531)	174,531	-90%
Special Item - FMV Adjustment in Housing Units and Lots Held for Sale	(1,523,117)	1,992,854	(3,515,971)	-176%
Total General Revenues, Transfers and Special Items	(1,543,117)	3,991,976	(5,535,093)	-139%
Change in Net Position	(703,452)	(69,188)	(634,264)	917%
Net Position at Beginning of the Year, as Previously Reported	102,327,302	101,016,987	1,310,315	1%
Prior Year Adjustment	(9,851,139)	(8,471,636)	(1,379,503)	16%
Net Position at Beginning of the Year, as Restated	92,476,163	92,545,351	(69,188)	0%
Net Position, Ending	$ 91,772,711	$ 92,476,163	$ (703,452)	-1%

continue

3. Governmental Fund Results – Balance Sheet

	2019 Combined	2018 Combined	Change	Percent
ASSETS				
Cash and Cash Equivalent	$ 138,396,348	$ 30,427,713	$ 107,968,635	355%
Certificate of Deposit	195,050	-	-	-
Note Receivable - Related	11,475,230	11,081,826	393,404	4%
Other Account Receivable				
Grants Receivable	164,144,855	302,698,614	(138,553,759)	-46%
Other State Funds Receivable	25,739,365	21,271,505	4,467,860	21%
Due from Other Funds	6,220,822	8,707,680	(2,486,858)	-29%
Prepaid and Other Assets	516,070	687,345	(171,275)	-25%
Total Assets	**$ 346,687,740**	**$ 374,874,683**	**$ (28,381,993)**	**-8%**
LIABILITIES				
Account Payable and and Accrual Liabilities	$ 277,052,769	$ 235,388,204	$ 41,664,565	18%
Cash Overdraft	813,962	-	813,962	100%
Due to Other Governmental Entities	829,284	69,870,766	(69,041,482)	-99%
Due to Other Funds	6,220,822	8,707,680	(2,486,858)	-29%
Total Liabilities	**284,916,837**	**313,966,650**	**(29,049,813)**	**-9%**
DEFERRED REVENUES	**1,291,585**	**-**	**1,291,585**	**100%**
FUND BALANCE	**60,479,318**	**60,908,033**	**667,820**	**1%**
Total Liabilities and Fund Balance	**$ 346,687,740**	**$ 374,874,683**	**$ (28,381,993)**	**-8%**

4. Governmental Fund Results Statement of Revenues, Expenditures and Changes in Fund Balances

- Total revenues and expenditures increased by approximately $754.2 million and $752.6 million, respectively, which is mostly driven by the activities financed by the STEP Federal Program.

continue

4. Governmental Fund Results Statement of Revenues, Expenditures and Changes in Fund Balances (continued)

	2019 Combined	2018 Combined	Change	Percent
Revenues				
Appropriation from the Commonwealth	$ 54,163,050	$ 24,004,667	$ 30,158,383	126%
Sale and Lease of Land Lots	1,522,178	1,555,009	(32,831)	-2%
Rent	1,754,123	3,000,000	(1,245,877)	-42%
Indirect Costs	4,986,252	5,786,673	(800,421)	-14%
Federal Grants	1,087,015,006	361,262,686	725,752,320	201%
Interest and Investment Income	1,446,972	592,483	854,489	144%
Management and Developers Fees	153,555	82,083	71,472	87%
Other	77,572	679,241	(601,669)	-89%
Total Revenue	**1,151,118,708**	**396,962,842**	**754,155,866**	**190%**
Expenditures				
General and Administrative	121,187,852	156,803,567	(35,615,715)	-23%
Construction and Rehabilitation	969,595,505	184,396,458	785,199,047	426%
Tenant, Utility Services and Maintenance	56,379,849	54,467,280	1,912,569	4%
Capital Outlay	782,486	51,664	730,822	1415%
Debt Services Payments				
Principal	2,994,710	2,734,820	259,890	10%
Interest	587,021	504,043	82,978	16%
Total Expenditures	**$ 1,151,527,423**	**$ 398,957,832**	**$ 752,569,591**	**189%**

5. Budgetary Information

There were no significant differences between the amended budget and actual amounts in the general fund. The information is presented as follows:

	Original Budget	Amended Budget	Actual	Variance
Revenues				
Legistalive Appropriations	$ 10,524,000	$ 11,872,180	$ 11,872,180	$ -
Expenditures				
General and Administrative	(10,524,000)	(11,872,180)	(10,261,371)	1,610,809
Excess of Revenues Over Expenditures	**$ -**	**$ -**	**$ 1,610,809**	**$ 1,610,809**

6. Capital Assets

On June 30, 2019, the PRDH had $37,122,106 invested in Capital Assets, net of depreciation, including building, equipment, furniture and fixtures, and vehicles. The net decrease of $1,361,353 when compared with balance on June 30, 2018 is mostly related to the depreciation expense during the year. Please, find below the summarized information regarding the capital assets as of June 30, 2019:

continue

6. Capital Assets (continued)

Capital Assets:	
Non Depreciable Capital Assets	
Land	$ 850,831
Construction in Progress	339,924
	1,190,755
Depreciable Capital Assets	
Building	30,000,000
Building Improvements	21,525,268
Furniture, Equipment and Vehicles	6,645,161
Parking and Building	5,164,129
Total Depreciable Capital Assets	63,334,558
Less Accumulated Depreciation	(27,403,207)
Total Depreciable Capital Assets, Net	35,931,351
Total Capital Assets, Net	**$ 37,122,106**

7. Long-Term Liabilities

As of June 30, 2019, the PRDH had a short-term line of credit to the Puerto Rico Housing Finance Authority (PRHFA) and a note payable to the Governmental Development Bank (GDB) with outstanding balances of $5,230,118 and $8,976,243, respectively. Management is in the process of refinancing the balance due of the short-term line of credit. The note payable to GDB is debt backed by the full faith and credit of the PRDH. In addition, the PRDH had a note payable to the Federal Emergency Management Agency (FEMA) with an outstanding balance of $6,581,592 as of June 30, 2019. Please see Note K for further details.

8. Deferred Outflows of Resources

Deferred outflows of resources, although similar to "assets," is set apart because these items do not meet the technical definition of being an asset of the PRDH on the date of these financial statements. In other words, these amounts are not available to pay liabilities in the way assets are available. When all the recognition criteria are met, the deferred outflow of resources will become an expense/expenditure.

The most significant deferred outflow of resources reported are related to the implementation of GASB Statement No. 68 and GASB Statement No. 71 for pension liability reporting. GASB 71 requires that contributions made during the fiscal year to the retirement system be reported as deferred outflows of resources. Consequently, the majority of the deferred outflows of resources reported are comprised of current year contributions to the retirement system. However, there may be some deferred outflows of resources attributable to the various components that impact pension changes, and can include investment changes amortization, changes due to actuarial assumptions, and differences between expected or actual experience.

continue

9. Deferred Inflows of Resources

Deferred inflows of resources are the counterpart to deferred outflows of resources on the Statement of Net Position. Deferred inflows of resources are not technically liabilities of the PRDH as of the date of the financial statements. When all the recognition criteria are met, the deferred inflow of resources will become revenue or an increase to net position.

Deferred inflows of resources related to pensions represent a net amount attributable to the various components that impact pension changes, and can include investment changes amortization, changes due to actuarial assumptions, and differences between expected or actual experience.

More detailed information about the PRDH's deferred outflows of resources and deferred inflows of resources is presented in Note J to the basic financial statements on page 63 of this report.

GOING CONCERN – COMMONWEALTH OF PUERTO RICO

As explained on Note T to the basic financial statements on pages 79-81 of this report, the Commonwealth of Puerto Rico (Commonwealth) currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base, has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services, like the PRDH, which is part of the Commonwealth.

The Commonwealth will not be able to honor all of its obligations as they come due while at the same time providing essential government services. These factors create an uncertainty about the Primary Government's ability to continue as a going concern. Accordingly, because the PRDH is part of the Commonwealth, and depend on the appropriation of the Commonwealth, that create an uncertainty about the PRDH's ability to continue as a going concern.

PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA)

The Puerto Rico Oversight, Management, and Economic Stability Act, Pub. Law 114-187 ("PROMESA" or the "Act"), was enacted into law on June 30, 2016. The Senate had passed PROMESA on June 29, 2016, and President Obama signed the Act into law on June 30, 2016, one day before the Commonwealth of Puerto Rico was expected to, and did, default on substantial payment obligations.

On May 27, 2020, the Oversight Board certified its most recent fiscal plan for the Commonwealth (the Oversight Board Fiscal Plan), which proposes a set of Government efficiency measures that the Government must take ("measures") to increase government revenues and make government more responsive. More detailed information about PROMESA is presented in Note U to the financial statements on pages 81 through 113 of this report.

CONTACTING THE PRDH'S FINANCIAL MANAGEMENT

The PRDH's financial statements are designed to present users with a general overview of its finances. If you have questions about the report or need additional information, please contact the Finance Director.

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	Primary Government
	Governmental Activities
ASSETS:	
Current Assets:	
Cash and Cash Equivalents	$ 138,396,348
Certificate of Deposit	195,050
Interest Receivable on Note	2,720,399
Other Account Receivable	
Grants Receivable	164,144,855
Other State Funds Receivable	9,116,123
Prepaid and Other Assets	515,470
Total Current Assets	315,088,245
Non Current Assets:	
Note Receivable frorm Related Entity, Noncurrent Portion	8,754,831
Notes Receivable from Developer	39,733,679
Due from Related Entity, Noncurrent Porttion	72,522,474
Housing Units and Land Lots Held for Sale	33,598,468
Restricted Land Lot	19,200,000
Capital Assets, Net	37,122,106
Total Noncurrent Assets	210,931,558
TOTAL ASSETS	**526,019,803**
DEFERRED OUTFLOWS OF RESOURCES:	
Contributions to Employees Retirement System	9,597,059
TOTAL DEFERRED OUTFLOWS OF RESOURCES	**9,597,059**

continue

	Primary Government
	Governmental Activities
LIABILITIES:	
Current liabilities:	
Account Payable	277,052,769
Cash Overdraft	813,962
Due to Other Governmental Entities	829,284
Notes Payable, Current Portion	11,127,393
Accrued Compensated Absences, Current Portion	124,713
Accrued Termination Benefits, Current Portion	836,126
Total Current Liabilities	290,784,247
Long-Term Liabilities:	
Accounts Payable	43,977,565
Note Payable, Long-Term Portion	9,660,560
Accrued Legal Claims, Long-Term Portion	3,280,284
Accrued Compensated Absences, Long Term Portion	1,334,715
Accrued Termination Benefits, Long Term Portion	3,639,952
Net Pension Liability	66,822,303
Other Postemployment Benefit Obligation	6,439,762
Total Long-Term Liabilities	135,155,141
TOTAL LIABILITIES	**425,939,388**
DEFERRED INFLOWS OF RESOURCES:	
Unamortized Investment in Employees Retirement System	17,904,763
TOTAL DEFERRED INFLOWS OF RESOURCES	**17,904,763**
NET POSITION:	
Net Investment in Capital Assets	28,145,863
Restricted for:	
Supply of Low and Moderate Income Housing	7,520,974
Special Revenue Funds	2,013,820
Unrestricted	54,092,054
TOTAL NET POSITION	**$ 91,772,711**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

Functions/Programs	Expenses	Program Revenues: Charges For Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grant and Contributions	Net (Expenses) Revenue and Changes in Net Position
Governmental Activities:					
General and Administrative	$ 125,484,726	$ 6,817,947	$ 107,446,089	$ -	$ (11,220,690)
Construction and Rehabilitation	969,595,505	-	969,241,991	265,000	(88,514)
Housing Sales and Adjustments	-	1,522,178	-	-	1,522,178
Tenant, Utility Services and Maintenance	56,379,849	-	65,516,561	-	9,136,712
Interest Expenses	587,021	-	-	-	(587,021)
Total Governmental Activities	**$ 1,152,047,101**	**$ 8,340,125**	**$ 1,142,204,641**	**$ 265,000**	**(1,237,335)**
General Revenues:					
Management and Developer Fees					153,555
Interest and Investment Income					1,923,445
Total General Revenues					2,077,000
Transfers and Special Items:					
Net Transfers to Other Agencies/Entities					(20,000)
FMV Adjustment in Housing Units and Lots Held for Sale					(1,523,117)
Total General Revenues and Transfers and Special Items					(1,543,117)
CHANGE IN NET POSITION					(703,452)
Net Position - Beginning of Year					102,327,302
Prior Period Adjustments					(9,851,139)
Net Position - Beginning of Year, As Restated					92,476,163
NET POSITION - END OF YEAR					**$ 91,772,711**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

	General Fund	Section 8 Housing Choice Vouchers Program Fund	FEMA Recovery Fund	CDBG	CDBG-DR	Self-Contribution Fund	Sales and Acquisition Fund	Other Governmental Funds	Total Governmental Funds
ASSETS:									
Cash and Cash Equivalent	$ 1,626,443	$ 6,932,144	$ 111,513,039	$ -	$ -	$ 4,004,791	$ 453,841	$ 13,866,090	$ 138,396,348
Certificate of Deposit	-	-	-	-	-	-	-	195,050	195,050
Notes Receivable - Related	-	-	-	-	-	11,475,230	-	-	11,475,230
Other Account Receivable									
Grants Receivable	-	963,283	152,877,459	5,964,783	4,330,120	-	-	9,210	164,144,855
Other State Funds Receivable	-	-	1,245,081	-	-	16,776,514	25,556	7,692,214	25,739,365
Due from Other Funds	-	-	-	-	-	34,355	6,105,667	80,800	6,220,822
Prepaid and Other Assets	515,470	-	-	-	600	-	-	-	516,070
Total Assets	**$ 2,141,913**	**$ 7,895,427**	**$ 265,635,579**	**$ 5,964,783**	**$ 4,330,720**	**$ 32,290,890**	**$ 6,585,064**	**$ 21,843,364**	**$ 346,687,740**
LIABILITIES:									
Account Payable and Accrual Liabilities	$ -	$ 238,966	$ 265,541,117	$ 5,324,784	$ 3,280,969	$ 1,689,202	$ 245	$ 977,486	$ 277,052,769
Cash Overdraft	-	-	-	520,078	293,884	-	-	-	813,962
Due to Other Governmental Entities	-	-	-	73,417	755,867	-	-	-	829,284
Due to Other Funds	-	181,991	94,462	-	-	5,418,177	-	526,192	6,220,822
Total Liabilities	**-**	**420,957**	**265,635,579**	**5,918,279**	**4,330,720**	**7,107,379**	**245**	**1,503,678**	**284,916,837**
DEFERRED INFLOWS OF RESOURCES:									
Deferred Revenues	-	-	1,245,081	46,504	-	-	-	-	1,291,585
FUND BALANCES:									
Nonspendable	515,470	-	-	-	-	28,174,210	-	-	28,689,680
Restricted	-	7,474,470	-	-	-	-	-	2,013,820	9,488,290
Committed	-	-	-	-	-	879,123	-	15,014,381	15,893,504
Assigned	1,626,443	-	-	-	-	-	6,584,819	3,311,485	11,522,747
Unassigned (Deficit)	-	-	(1,245,081)	-	-	(3,869,822)	-	-	(5,114,903)
Total Fund Balances (Deficit)	**2,141,913**	**7,474,470**	**(1,245,081)**	**-**	**-**	**25,183,511**	**6,584,819**	**20,339,686**	**60,479,318**
Total Liabilities, Deferred Inflows of Resources, and Fund Balances (Deficit)	**$ 2,141,913**	**$ 7,895,427**	**$ 265,635,579**	**$ 5,964,783**	**$ 4,330,720**	**$ 32,290,890**	**$ 6,585,064**	**$ 21,843,364**	**$ 346,687,740**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

Total Fund Balance - Government Fund (Page 22)		**$ 60,479,318**
Amounts reported for Governmental Activities in the Statement of Net Position are different because:		
Account Receivable from Related Entity is not a financial resources and not reported in the funds.		55,898,632
Account Receivable from Developer is not a financial resources and not reported in the funds.		39,733,679
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds.		37,122,106
Land lots held for sale or lease are not current financial resources and therefore not reported in the funds		33,598,468
Land lots restricted for long term credit line are not current financial resources and therefore not include in the funds		19,200,000
Contributions to the pension plan in the current fiscal year are deferred outflows of resources on the Statement of Net Position		9,597,059
Deferred inflows of resources reported in the governmental funds are recognized as revenue in the governmental activities		1,291,585
Pension Related Deferrals		(17,904,763)
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
Accounts Payable Long-Term	$ (43,977,565)	
Note Payable	(20,787,953)	
Legal Claims	(3,280,284)	
Compensated Absences	(1,459,428)	
Accrued Termination Benefits	(4,476,078)	
Net Pension Liability	(66,822,303)	
Other Postemployment Benefit Obligation	(6,439,762)	
Total Net Noncurrent Liabilities		(147,243,373)
Total Net Position (Page 20)		**$ 91,772,711**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	General Fund	Section 8 Housing Choice Vouchers Program Fund	FEMA Recovery Fund	CDBG	CDBG-DR	Self-Contribution Fund	Sales and Acquisition Fund	Other Governmental Funds	Total Governmental Funds
REVENUES:									
Appropriation from Commonwealth	$ 11,872,180	$ -	$ 28,023,718	$ -	$ -	$ 14,002,152	$ -	$ 265,000	$ 54,163,050
Sale and Lease of Housing Units and Land Lots	-	-	-	-	-	1,503,940	-	18,238	1,522,178
Rent	-	-	-	-	-	-	-	1,754,123	1,754,123
Indirect Cost	-	-	-	-	-	-	-	4,986,252	4,986,252
Federal Grants	-	63,114,665	1,004,654,027	11,433,656	6,702,347	-	-	1,110,311	1,087,015,006
Interest and Investment Income	-	40,826	-	-	12	393,404	994,999	17,731	1,446,972
Management and Developers Fees	-	-	-	-	-	84,545	-	69,010	153,555
Other	-	28,704	-	-	-	6,565	-	42,303	77,572
Total Revenues	11,872,180	63,184,195	1,032,677,745	11,433,656	6,702,359	15,990,606	994,999	8,262,968	1,151,118,708
EXPENDITURES:									
Current									
General and Administrative	10,487,925	6,087,451	78,280,821	475,191	4,060,838	18,229,509	586,279	2,979,838	121,187,852
Construction and Rehabilitation	-	-	955,642,005	10,958,465	2,641,521	73,879	-	279,635	969,595,505
Tenant, Utility Services and Maintenance	-	55,316,306	-	-	-	72,802	386	990,355	56,379,849
Capital Outlays	-	179,567	-	-	-	3,660	-	599,259	782,486
Debt Service:				-					
Principal	-	-	-	-	-	-	-	2,994,710	2,994,710
Interest	-	-	-	-	-	-	-	587,021	587,021
Total Expenditures	10,487,925	61,583,324	1,033,922,826	11,433,656	6,702,359	18,379,850	586,665	8,430,818	1,151,527,423
EXCESS OF REVENUE OVER (UNDER) EXPENDITURES	1,384,255	1,600,871	(1,245,081)	-	-	(2,389,244)	408,334	(167,850)	(408,715)
OTHER FINANCING SOURCES (USES):									
Pass-Through from (to) Other Agencies/Entities	-	-	-	-	-	-	-	(20,000)	(20,000)
Transfers - In	-	-	-	-	-	-	-	348,448	348,448
Transfers - Out	-	-	-	-	-	(348,448)	-	-	(348,448)
Total Other Financing Sources (Uses)	**-**	**-**	**-**	**-**	**-**	**(348,448)**	**-**	**328,448**	**(20,000)**
Net Change In Fund Balances	**1,384,255**	**1,600,871**	**(1,245,081)**	**-**	**-**	**(2,737,692)**	**408,334**	**160,598**	**(428,715)**
Fund Balances - Beginning	757,658	5,873,599	-	-	-	27,921,203	6,176,485	20,179,088	60,908,033
FUND BALANCES - ENDING (DEFICIT)	**$ 2,141,913**	**$ 7,474,470**	**$ (1,245,081)**	**$ -**	**$ -**	**$ 25,183,511**	**$ 6,584,819**	**$ 20,339,686**	**$ 60,479,318**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

Net Change in Fund Balances - Government Fund (Page 24)		**$ (428,715)**
Amount reported for Governmental Activities in the Statement of Activities are different because:		
Governmental funds report capital outlay as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful life and reported as depreciation expense. In the current period, these amounts are:		
Capital Outlays	$ 782,486	
Depreciation Expense	(2,143,839)	
Excess of Depreciation Expense over Capital Outlays		(1,361,353)
Revenues in the Statement of Activities that do not provide the use of current financial resources are not reported as revenues in the funds. These activities consist of:		
Deferred Revenues		1,291,585
Interest on Mortgage Receivable from Related Party		476,473
Changes in Fair Value of Housing Units Held for Sale are not recorded in the Governmental Fund Reports. However, these changes represent an unrealize gain or loss in the Statement of Activities.		(1,523,117)
Some expense reported in the Statement of Activities do not require the use of current financial resources and therefore are not reported as expenditure in governmental funds. These activities consist of:		
Pension Expense	816,440	
Increase in Accounts Payable	(2,896,516)	
Decrease in Notes Payable	2,994,710	
Decrease in Compensated Absence	(192,522)	
Change in Allowance for Doubtful Account VM-1	(373,447)	
Decrease in Accrued Termination Benefits	493,010	
Total Additional Expenses		841,675
Change in Net Position of Governmental Activities (Page 21)		**$ (703,452)**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

	Agency Funds		
	Ponce en Marcha Fund	Special Communities Fund	Remedy Fund
ASSETS:			
Restricted Cash	$ 336,751	$ 24,947	$ 1,051,775
TOTAL ASSETS	**$ 336,751**	**$ 24,947**	**$ 1,051,775**
LIABILITIES:			
Due to Government Units	$ 336,751	$ 24,947	$ 1,051,775
TOTAL LIABILITIES	**$ 336,751**	**$ 24,947**	**$ 1,051,775**

The accompanying Notes to the Basic Financial Statements are an integral part of this Statement.

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Commonwealth of Puerto Rico 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 assignation of powers to the executive, legislative and judicial branches of the government. The Commonwealth assumes responsibility for public safety, public health, public housing, wealth, education and economic development.

The Department of Housing of the Commonwealth of Puerto Rico (PRDH) was created by Act No. 97 of June 10, 1972. Through a Secretary appointed by the Governor of the Commonwealth, the PRDH is engaged in the implementation of the governmental policy related to the public housing. This includes, among other things, the acquisition, sale, lease and operation of public housing projects and land development to provide housing to low and moderate-income families.

By Act No. 58 of August 9, 1991, the Puerto Rico Public Housing Administration (PRPHA), created by Act No. 66 of August 17, 1989, was ascribed to the PRDH, and designated to assume certain assets, liabilities and operations of the Puerto Rico Urban Renewal and Housing Corporation (PRURHC), to liquidating them under the responsibility of the PRDH.

Financial Reporting Entity

The PRDH is for financial reporting purposes, part of the Commonwealth of Puerto Rico. Because PRDH is part, for financial reporting purposes, of the Commonwealth, its financial data is included as part of the Commonwealth of Puerto Rico financial statements.

The PRDH accompanying financial statements are issued solely to comply with Title 2 U.S. Code of Federal Regulations (CFR) Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance) and for the information and use of the PRDH management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Summary of Significant Accounting Policies

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

Basis of Presentation and Fund Accounting

The accompanying basic financial statements present the financial position of the governmental activities, business-type activities, each major governmental fund, and the aggregate remaining fund information of PRDH at June 30, 2019, and the respective changes in financial position, and the cash flows, where applicable, thereof for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, each major governmental fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2019 in conformity with GAAP.

The minimum required financial statement presentation applicable to PRDH is composed of the following elements: (1) government-wide financial statements (GWFS), (2) governmental fund financial statements (GFFS), (3) notes to the basic financial statements, and (4) required supplementary information (RSI).

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The basic financial statements of PRDH have been prepared in conformity with accounting principles generally accepted in the United Stated of America as applicable to local governmental units. The basic financial statements include both government-wide (based on PRDH as a whole) and fund financial statements, which provide a more detailed level of financial information. Both the government-wide and fund financial statements (within the basic financial statements) categorize primary activities as governmental.

The financial information of PRDH is presented in this report as follows:

Required Supplementary Information – Management's Discussion and Analysis

Management's discussion and analysis is required supplementary information that introduces the basic financial statements and provides an analytical overview of PRDH's financial activities.

Government-wide Financial Statements (GWFS)

While separate government-wide and fund financial statements are presented, they are interrelated. The GWFS (the *Statement of Net Position* and the *Statement of Activities*) report information of all the activities of PRDH. For the most part, the effect of interfund activity has been removed from these financial statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which rely, to a significant extent, on fees and charges to external customers for support.

The focus of the *Statement of Net Position* is designed to be similar to bottom line results for PRDH's governmental activities and business type activities. This statement combines and consolidates governmental fund's current financial resources (short-term spendable resources) with capital assets and long-term obligations. The *Statement of Net Position* presents the reporting entities' assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference reported as net position. Net positions are classified as net investment in capital assets, restricted when constraints are placed on them that are imposed by external parties or by laws or regulations, and unrestricted. Designations solely imposed by PRDH's management are not presented as restricted net position.

The *Statement of Activities* presents a comparison between direct expenses and program revenues for the different business-type activities of PRDH and for each function of PRDH's governmental activities. *Direct expenses* are those that are clearly identifiable with a specific function or segment. In addition, to the extent that indirect costs are allocated to the various functions, the program expenses will include both direct and indirect costs. *Program Revenues* include charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges provided by a given function or segment, and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items properly excluded from program revenues are reported instead as *general revenues*.

Governmental Funds Financial Statements (GFFS)

The GFFS [the *Balance Sheet*, and the *Statement of Revenues, Expenditures and Changes in Fund Balance*] provide information about PRDH's funds. The emphasis of fund financial statements is on major governmental funds, each displayed in a separate column. Non-major funds are summarized into a single column.

This presentation deemed most appropriate to (1) demonstrate legal and covenant compliance, (2) demonstrate the source and use of liquid resources, and (3) demonstrate how PRDH's actual experience conforms to the budgeted fiscal plan.

The accounts of PRDH are organized on the basis of governmental funds. Each fund is accounted for by a separate set of self-balancing accounts that comprises its assets, liabilities, fund balance, revenues and expenditures.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Fund financial statements report detailed information about PRDH. The focus of GFFS is on major funds rather than reporting funds by type. Each major fund is presented in a separate column.

By definition, the general fund is always considered a major fund. Governmental funds other than the general fund must be reported as major funds if they meet both the ten percent and five percent criterion, defined respectively, (1) an individual governmental fund reports at least ten percent of any of the following: a) total governmental fund assets, b) total governmental fund liabilities, c) total governmental fund revenues, or d) total governmental fund expenditures; (2) an individual governmental fund reports at least five percent of the aggregated total for both governmental funds and enterprise funds of any one of the items for which it met the ten percent criterion. In addition, a fund may be reported as major if it is believed to be of particular importance to financial statement users.

The following are the governmental funds presented in the financial statements as of, and for the year ended June 30, 2019:

General Fund – This fund includes the current financial resources, which relate to the general operations of the PRDH. These operations consist of the general administration and other activities.

Section 8 Housing Choice Vouchers Program Fund – This major fund accounts for grants received from HUD. The Grant is restricted for accomplishing objectives of the Housing Vouchers Program, which provides rental assistance to help very low-income families afford decent, safe and sanitary rental housing.

FEMA Recovery Fund – This major fund accounts for grants received from Federal Emergency Management Administration (FEMA) through the Sheltering and Temporary Essential Power (STEP) Pilot Program. The grant is restricted for providing minor emergency repairs to single-family owner-occupied residences.

CDBG Fund - This major fund accounts for grants received from HUD. The grant is restricted for the Community Development Block Grant program. This program provides annual grants to municipalities to develop viable urban communities by providing decent housing and a suitable living environment, and by expanding economic opportunities, principally for low- and moderate-income persons.

CDBG-DR Fund - This major fund accounts for grants received from HUD. The grant is restricted for the Community Development Block Grant Disaster Recovery Program. This program provides grants to rebuild areas affected by Presidentially declared disasters and provide crucial seed money to start the recovery process. Since CDBG Disaster Recovery (CDBG-DR) assistance may fund a broad range of recovery activities, it is designed to communities and neighborhoods that otherwise might not recover due to limited resources.

Self-Contribution Fund – This fund is maintained by the PRDH to account for current financial resources received from proceeds of sale and rent of land lots, indirect costs, fees for elderly care and other revenues collected from sources other than intergovernmental or federal subsidies. Also, it includes the resources and expenditures received and used respectively for the improvement of the PRDH's main-building.

Sales and Acquisition Fund – This fund is maintained by the PRDH to account for current financial resources received to liquidate the assets of the former Puerto Rico Urban Renewal and Housing Corporation (PRURHC) and to meet its financial obligations with the proceeds to sales.

Other Governmental Funds – Accounts for and reports other financial resources not included in the General Fund or the Special Revenue Fund.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The financial statements of the governmental funds are the following:

Balance Sheet – Governmental Funds – Report's information on June 30, 2019 about the current financial resources (assets, liabilities, deferred inflows of resources and fund balances) of each major governmental fund.

Statement of Revenues, Expenditures and Changes in Fund Balance – Governmental Funds – Report's information about the inflows, outflows and balances of current financial resources of each major governmental fund for the fiscal year ended June 30, 2019.

Since the GFFS are presented in different measurement focus and basis of accounting than the GWFS, reconciliation is presented and separate explanation for each difference.

In addition, the PRDH reports the following fiduciary fund:

Agency – This fiduciary fund is custodial in nature (assets equal liabilities) and does not involve measurement of the PRDH results of operations (see Note O).

The financial statement of the fiduciary fund is the following:

Statement of Fiduciary Net Position – Assets and liabilities are presented in a classified format to distinguish between current and long-term assets and liabilities. No deferred outflows/inflows of resources are presented.

Further, certain activity occurs during the fiscal year involving transfers of resources between funds. In GFFS these amounts are reported at gross amounts as transfers in/out. While reported in GFFS, certain eliminations are made in the preparation of the GWFS. Transfers between the funds included in governmental activities are eliminated so that only the net amount is included as transfers in the governmental activities' column. Similarly, balances between the funds included in business-type activities are eliminated so that only the net amount is included as internal balances in the business-type activities column.

PRDH reports its financial position (*Balance Sheet*) and results of operations [*Statement of Revenues, Expenditures (Expenses) and Changes in Fund Balance/Net Position*] in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

Notes to the Basic Financial Statements

The notes to the basic financial statements provide information that is essential to a user's full understanding of the data provided in the basic financial statements.

Required Supplementary Information – Budgetary Comparison Schedule – General Fund (Unaudited)

The basic financial statements are followed by a section of required supplementary information. This section includes a *Budgetary Comparison Schedule – General Fund*, which includes reconciliation between the statutory fund balance for budgetary purposes and the fund balance for the General Fund as presented in the GFFS.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Required Supplementary Information – Employees Retirement System (Unaudited)

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, revises existing standards for measuring and reporting pension liabilities for pension plans provided by the PRDH to its employees, and required supplementary information that include the Schedule of Proportionate Share of the Net Pension Liability and Schedule of Contributions to the Employees' Retirement Systems.

Measurement Focus and Basis of Accounting

The accounting and financial reporting treatment is determined by the applicable measurement focus and basis of accounting. Measurement focus indicates the type of resources being measured such as current financial resources or economic resources. The basis of accounting indicates the timing of transactions or events for recognition in the financial statements.

Government-wide Financial Statements

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Nonexchange transactions, in which PRDH gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been met, other than time requirements. These resources relate to a future period (when the advance is first permitted to be used in accordance with the government-mandated nonexchange transaction or a voluntary nonexchange transaction) and, therefore, should be classified as a deferred inflow of resources until such time as the resources are first permitted to be used. Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

Federal grants revenues are financial resources approved by HUD and are recorded in the accounting period in which the resources are collectible and available for expenditure in the current accounting period. Legislative appropriations, which represent annual appropriations from the Commonwealth of Puerto Rico, are recorded when approved, collectible and available for expenditure in the current accounting period.

The *Statement of Net Position* and the *Statement of Activities* display information of all of the non-fiduciary activities of PRDH, the primary government, as a whole. PRDH activities are considered governmental type.

The government-wide statements are prepared using the economic resources measurement focus and the accrual basis of accounting. This approach differs from the manner in which governmental fund financial statements are prepared. Therefore, governmental fund financial statements include reconciliations with brief explanations to better identify the relationship between the government-wide statements and the statements for governmental funds.

For the most part, the effect of inter-fund activity has been removed from these statements. The government-wide *Statement of Activities* presents a comparison between expenses, both direct and indirect, and program revenues for each of the programs of the governmental activities of PRDH.

Direct expenses are those that are specifically associated with a service or program and therefore clearly identifiable to a particular function. Indirect expenses for centralized services and administrative overhead are allocated among the programs and functions using a full cost allocation approach and are presented separately to enhance comparability of direct expenses between governments that allocate direct expenses and those that do not.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Program revenues include changes paid by the recipients of the goods or services offered by the programs and grants and contributions that are restricted to meeting the operational or capital requirements of a particular program. Revenues which are not classified as program revenues are presented as general revenues.

The comparison of program revenues and expenses identifies the extent to which each program is self-financing or draws for the general revenues of PRDH.

Governmental Funds Financial Statements

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For these purposes, PRDH considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Revenues that PRDH earns by incurring obligations are recognized in the same period as when the obligations are recognized. On June 30, 2019, all revenues sources met this availability criterion.

Entitlements are recorded as revenues when all eligibility requirements are met, including any time requirements and the amount is received during the period or within the availability requirements have been met, and the amount is received during the period or within the availability period for this revenue source (60 days of year-end). However, those resources not available for spending in the current period and, therefore should be classified as a deferred inflow of resources. Expenditures-driven grants are recognized as revenue when the qualifying expenditures have been incurred and all other eligibility requirements have been met, and the amount is received during the period or within the availability period for this revenue source (within 60 days of year-end). Accordingly, such resources should be reported as unearned revenue in the liability section of the general fund's *Balance Sheet*. All other revenue items are considered to be measurable and available only when cash is received by PRDH.

Expenditures are recorded when the related fund liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences, and claims and judgments, are recorded only when payment is due. General capital asset acquisitions are reported as expenditures in governmental funds. Principal and interest on notes payable are recorded when they matured (when payment is due). Proceeds of long-term debt and acquisitions under capital leases, if any, are reported as other financing sources.

The accompanying *Balance Sheet – Governmental Funds* generally reflects only assets that will not be converted into cash to satisfy current liabilities. Long-term assets and those assets that will not be converted into cash to satisfy current liabilities are generally not accounted for in the accompanying *Balance Sheet – Governmental Funds*.

The measurement focus of the GFFS is on decreases of net financial resources (expenditures) rather than expenses. Most expenditures are measurable and are recorded when the related governmental fund liability is incurred. Allocation of costs, such as depreciation and amortization, are recorded in the accompanying *Statement of Activities*, but are not recorded in the accompanying GFFS.

Statutory (Budgetary) Accounting

The PRDH's total available spending authorization, which is considered its budget, is adopted in accordance with a statutory basis of accounting, which is not in accordance with the modified accrual basis of accounting. Revenues are generally recognized when cash is received.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances will lapse the year following the end of the fiscal year when the encumbrance was established, by means of Act No.123 from August 17, 2001, which amended the existing appropriations and encumbrances lapsing provision of Act No. 230 from July 23, 1974.

Amounts required settling claims and judgments against the PRDH, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. Under the statutory basis of accounting, the PRDH uses encumbrance accounting to record the full amount of purchase orders, contracts and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the PRDH governmental funds, encumbrance is a significant aspect to budget control.

Budgetary Control

On January 2, 2017, the Governor of Puerto Rico signed the Executive Order No. 2017-005, which required that all departments, agencies, and instrumentalities of the Government of Puerto Rico and those expressly required by the Governor, are ordered to implement the Zero-Base Budget methodology for the preparation of the budget for fiscal year 2017-2018 and subsequent fiscal years, per the applicable techniques and approaches of Zero-Base Budget and should be in conformity with the Fiscal Plan approved by the Oversight Board for Puerto Rico, pursuant to the Federal Law Pub. L. 114-187, *Puerto Rico Oversight, Management and Economic Stability Act* (PROMESA).

For budgetary purposes, encumbrance accounting is used. The encumbrances (that is purchase orders, contracts and other commitments of appropriated resources) are considered expenditures when a commitment is made. For GAAP reporting purposes, encumbrances, outstanding at fiscal year-end are reported as reservations of budgetary appropriations and GAAP fund balances and do not constitute expenditures or liabilities on a GAAP basis, because such commitments will be honored during the subsequent fiscal year.

The Department of the Treasury and the Office of Management and Budget of Puerto Rico has the responsibility to ensure that budgetary spending control is maintained in the PRDH. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System ("PRIFAS"). PRIFAS ensures that encumbrances or expenditures are not processed if they exceed the PRDH's total available spending authorization. The legal level of budgetary control at the PRDH is for general fund expenditures.

Risk Financing

The Commonwealth of Puerto Rico purchases commercial insurance covering casualty, theft, tort, claims, and other losses for the PRDH. The PRDH reimburses the Commonwealth for premium payments made on its behalf. The PRDH's current insurance policies have not been canceled or terminated.

For workers' compensation, the State Insurance Fund Corporation, a component unit of the Commonwealth of Puerto Rico, provides the workers' compensation insurance to the PRDH's employees.

PRDH is authorized to deposit only in financial institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico, and such deposits should be kept in separate accounts in the name of the PRDH. The restricted cash includes purchase option deposits to be credited to sales of housing properties. The deposits are transferred to the general account when the sale is consummated.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Inter-Fund Balances

Inter-fund receivables and payables outstanding at year end are referred to as due to/from other funds. The Self-Contribution Fund provides services, at cost, to the HUD Programs Funds, with the attempts of recovering such amounts in a period of one (1) year or less. Also, the Sales and Acquisition fund maintains an inter fund balance (Receivable) with regards to the Self Contribution fund (Payable). Eliminations are made in the government-wide statements of the amounts reported as inter-fund receivables and payables.

Inter-Fund Transfers corresponds to invoices for security services paid from Other Governmental Fund for services received by Self-Contribution Fund, both funds are non-federal.

Capital Assets

Capital assets used in the governmental operations are accounted for in the government-wide financial *Statement of Net Position*, rather than in the Governmental Funds. When capital assets are purchased, such are recorded as capital outlays' expenditures in the governmental funds. They are stated at cost. Major modernizations and betterments are capitalized, while replacements, maintenance and repairs, which do not improve or extent the life of an asset, are not, when assets are sold, retired or otherwise disposed of, the cost is removed.

Depreciation of capital assets is computed and recorded under the straight-line method. Estimated useful lives of the various classes of depreciable capital assets are: parking and building to forty (40) years and other capital assets three (3) to five (5) years.

Deferred Outflows/Inflows of Resources

Deferred outflows of resources and deferred inflows of resources are defined in GASB Concept Statement No. 4, *Elements of Financial Statements*, as the acquisitions and consumptions of net assets by the government that is applicable to future periods. Pursuant to GASB Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position",* and GASB Statement No. 65, *"Items Previously Reported as Assets and Liabilities",* the PRDH recognizes deferred outflows and inflows of resources in the Statement of Financial Position in a separate section following Assets. Similarly, the PRDH reports deferred inflows of resources in the Statement of Net Position in a separate section following Liabilities. This separate financial statement element, *Deferred Outflows of* Resources, represent a consumption of net position that applies to a future period and so will not be recognized as an expense or expenditure until then. The PRDH has one item that meet this criterion - contributions made to the pension plan in fiscal year 2019. In addition to liabilities, the statement of financial position will sometime report a separate section for deferred inflows of resources. This separate financial statement element, *Deferred Inflows of* Resources, represents an acquisition of net position that applies to a future period and so will not be recognized as revenue until then. The PRDH has one item that meet the criterion for this category – deferrals of pension expense that results from the implementation of GASB Statement No. 68.

Based on this concept, PRDH reports the following as deferred outflows of resources and deferred inflows of resources.

- The deferred outflows of resources or deferred inflows of resources resulting from the implementation of GASB No. 68 and 71. Note M presents additional information about the composition of these items.

Note J provide details on deferred outflows of resources and deferred inflows of resources.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Compensated Absences

PRDH accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee. After the approval of Act No. 8 of February 6, 2017, as amended by Act No. 26 of April 29, 2017, PRDH's employees are granted 24 days of vacations and 12 days of sick leave annually. New employee accumulates retroactively after the first 3 months of employment. Vacations may be accumulated up to a maximum of sixty (60) days and sick leave up to a maximum of ninety (90) days. In the event of employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed at the current rate. Separation from employment prior to use of all or part of the sick leave terminates all rights for compensation. PRDH accrued a liability for compensated absences, which meet the following criteria: (1) PRDH 's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered; (2) the obligation relates to rights that vest or accumulate; (3) payment of the compensation is probable; and (4) the amount can be reasonably estimated.

In accordance with the above criteria and requirements in conformance with GASB Accounting Standards Codification Section C60, Compensated Absences, PRDH has accrued a liability for compensated absences, which has been earned but not taken by PRDH's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation pay using salary rates effective on June 30, 2019. All vacation pay is accrued when incurred in the GWFS. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations. Also, GFFS record expenditures when employees are paid for leave or the balance due in accrued upon the employee's separation from employment.

Reduction of Working Day

Act No. 8 of February 6, 2017 establishes that any employee will have the option of requesting a voluntary reduction of their working day by means of a prior agreement with their employer, for a reduction period equivalent to one day of work.

Mortgage Interest Income

Interest income on mortgages is recorded when collected due to the high delinquency rate.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and 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.

Cash and Cash Equivalents

The PRDH considers all highly liquid investments with maturity of three (3) months or less when purchased to be cash equivalents. The cash balances are available to meet current operating requirements in various interest-bearing accounts with the Governmental Development Bank, Commercial Banks.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Federal Grants

Contributions received from federal grants are credited to operating revenues under the HUD Programs in the accounting period in which they are earned and become measurable.

Housing Units and Lots Held for Sale

In June 2015, the Governmental Accounting Standards Board (GASB) issue Statement No. 75, *Fair Value Measurement and Application*. This Statement requires government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. With the adoption of the Statement, Housing Units and Lots Held for Sale are stated using a financial forecast developed by PRDH, due to the absent of reasonably available information's that indicates that market participants would use different assumption.

This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs–other than quoted prices–included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security.

PRDH apply Level 3 as the measure of evaluating its fair values for the Housing Units and Lots Held for Sale base on the nature of the assets being evaluated. PRDH does not record all changes in estimated realizable fair value of all the Housing Units and Lots Held for Sale due to Level 3 inputs are difficult to obtain on a regular basis and require verification from an outside party, and the high cost of appraisal services versus the short time benefit of one year of such services.

Fair Value

The PRDH follows the provisions of GASB Statement No. 72, *Fair Value Measurements and Application.* The fair value measurements made in the accompanying financial statements assume that transactions take place in the PRDH's principal market, or the PRDH's most advantageous market in the absence of a principal market. Fair values have been measured assuming that general market participants would act in their economic best interest.

To determine fair value measurements, fair values have not been adjusted for transaction costs and the PRDH has considered the unit of account of the asset or liability. The unit of account refers to the level at which an asset or a liability is aggregated or disaggregated for measurement, recognition, or disclosure purposes as provided by the accounting standards.

The PRDH has used valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair values. The techniques applied are consistent with one or more of the following approaches: (1) the market approach, (2) the cost approach, or (3) the income approach. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets, liabilities, or a group of assets and liabilities. The cost approach reflects the amount that would be required to replace the present service capacity of an asset. The income approach converts future amounts (such as cash flows or income and expenses) to a single current (discounted) amount. Valuation techniques have been applied consistently, though a change may be appropriate in certain circumstances.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The fair value measurements applied by management takes into account the highest and best use for a nonfinancial asset. A fair value measurement of a liability assumes that the liability would be transferred to a market participant and not settled with the counterparty. In the absence of a quoted price for the transfer of an identical or similar liability and if another party holds an identical item as an asset, the PRDH uses the fair value of that asset to measure the fair value of the liability. The PRDH's financial instruments consist of cash and cash equivalents, accounts and loans receivable, other assets, accounts payable and accrued liabilities, bonds and notes payable and other long-term obligations.

The three levels of the fair value hierarchy are described as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that we can access.

Level 2 - Inputs to the valuation methodology include:

- Quoted prices for similar assets or liabilities in active markets;
- Quoted prices for identical or similar assets or liabilities in inactive markets;
- Inputs other than quoted prices that are observable for the asset or liability; or
- Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specific (contractual) term, the Level 2 input must be observable for a substantial portion of the full term of the asset or liability.

Level 3 - Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Based on the criteria set forth above, the PRDH has classified its financial instruments as Level 2 instruments as of June 30, 2019.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The PRDH's valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs.

The observability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer would be reported at the beginning of the fiscal year. For the fiscal year ended June 30, 2019, there were no transfers from Level 2 to other categories.

The following methods and assumptions were used to estimate the fair values of the most significant financial instruments on June 30, 2019. There have been no changes in valuation methods.

- For cash in commercial banks and deposits with governmental bank, accounts and loans receivable, other assets and accounts payable and accrued liabilities, their respective estimated fair values approximate their carrying amounts recorded in the accompanying financial statements. The cost or contract value (net realizable value of assets and estimated settlement amounts of liabilities) was used to determine their respective fair values of these assets and liabilities due to their short-term nature and maturity periods.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- For bonds payable, notes payable and other Long-term obligations, the estimated fair values also approximate carrying amounts. These obligations have been incurred at the prevailing market interest rates and terms for these types of instruments, accordingly, the PRDH determined their fair values using valuation models that use observable market quotes.

Fair value reporting requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. The judgments made in determining the estimated fair value assigned to each financial instrument is significant and can materially impact the changes in net position and fund balances of the PRDH. The valuations are based on information available on June 30, 2019 and are based on expectations and assumptions that have been deemed reasonable by management.

Estimates developed using alternate are subjective, requiring significant judgments such as the amount and timing of future cash flows and the selection of appropriate discount rates that reflects market and credit risk.

The preceding valuation methods described may produce a fair value calculation that may not be indicative of net realizable or reflective of future fair values. Furthermore, while management believes that the PRDH's valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

However, the difference between the estimated fair values and carrying values of the PRDH's financial instruments were not considered significant by the PRDH on June 30, 2019.

Accounting for Pension Costs

In June 2012, the Governmental Accounting Standards Board (GASB) issued two new pronouncements related to the accounting and financial reporting requirements for pension related expenses and liabilities. GASB Statement No. 67, *Financial Reporting for Pension Plans an amendment of GASB Statement No. 25*, replaces the requirements of GASB Statement Nos. 25 and 50 for plans administered by pension systems through trusts or equivalent arrangements, and was implemented by the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS) as of June 30, 2014.

In addition, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for PRDH's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by PRDH to its employees. This Statement requires recognition of a liability equal to the Net Pension Liability, which is measured as the Total Pension Liability, less the amount of the pension plan's Fiduciary Net Position. The Total Pension Liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year-end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This Statement requires that most changes in the Net Pension Liability be included in pension expense in the period of the change. To the extent practical, the financial statements presented for the periods affected should be restated. Also, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment to GASB 68, is required to be implemented simultaneously with the provisions of GASB 68.

PRDH accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. During the current fiscal year, PRDH implemented the second pronouncement issued, GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*. This statement establishes accounting and financial reporting for pensions provided to the employees of state and local government employers through pension plans that are administered through trusts that have the following characteristics:

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable;

- pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms;

- pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members.

For the purpose of applying the requirements of GASB No. 68, as amended, the state government of the Commonwealth is considered to be the sponsor of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), a cost-sharing multi-employer Defined Benefit Pension Plan, and Defined Contribution Hybrid Program, in which the employees of the PRDH participate. PRDH is considered a participant of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth. Act No. 3 was enacted on April 4, 2013, amended the Act No. 447 for the purpose of establishing a major reform of the ERS effective on July 1, 2013. After that, and based in the fiscal crisis of the Commonwealth, was enacted the Act No. 106 of 2017 to establish a New Define Contribution Plan and create the "pay as you go" scheme for payment of pensioners of the ERS and other two retirement systems (see Note M).

For purposes of measuring the Net Pension Liability and Deferred Outflows/Inflows of Resources related to pensions, and pension expense, information about the fiduciary net position of the ERS and additions to/deductions from the ERS's fiduciary net position have been determined on the same basis as they are reported by Commonwealth of Puerto Rico. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Other Postemployment Benefits

In accordance with GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, that replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, changes similar to those implemented on GASB No. 67, *Financial Reporting for Pension Plans*, and No. 68, *Accounting and Financial Reporting for Pensions* should be made.

In addition to the pension benefits described above, the Commonwealth provides other retirement benefits, such as Christmas Bonus, and postemployment healthcare benefits (OPEB) for its retired employees in accordance with local law. Substantially, all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. There are no member or employer contributions on behalf of the MIPC. This benefit is financed on a pay-as-you-go basis from the General Fund of the Commonwealth (see Note O).

Net Position

Net position is the difference between assets and liabilities in the government-wide financial statements. Net position is segregated in the following three (3) categories:

Net Investment in Capital Assets – These consist of capital assets, less accumulated depreciation and reduced by any outstanding debt related to the acquisition, construction or improvement of those assets.

Restricted Net Position – Result when constraints placed on net assets use are either externally imposed by grantors, contributors, laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

<u>*Unrestricted*</u> – These consist of net position which do not meet the definition of the two (2) preceding categories.

Net Position Flow Assumption

Sometimes PRDH will fund outlays for a particular purpose from both restricted (e.g., restricted notes or grant proceeds) and unrestricted resources. In order to calculate the amounts to report as restricted net position and unrestricted net position in the government-wide financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is PRDH's policy to consider restricted net position to have been depleted before unrestricted net position is applied.

<u>Fund Balance</u>

PRDH implemented GASB Statement No. 54, *"Fund Balance Reporting and Governmental Fund Type Definitions".* This Statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on a government's fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

- *Nonspendable* – amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.
- *Restricted* – amounts constrained to specific purposes by their providers (such as grantors), through constitutional provisions, or by enabling legislation.
- *Committed* – amounts constrained to specific purposes by the PRDH itself, using its highest level of decision-making authority (such as legislation). To be reported as committed, amounts cannot be used for any other purpose unless the PRDH takes the same highest level action to remove or change the constraint.
- *Assigned* – amounts the PRDH intends to use for a specific purpose. Intent can be expressed by the PRDH or by an official or body to which the PRDH delegates the authority.
- *Unassigned* – all amounts not included in other spendable classifications.

This is typically done through adoption and amendment of the budget. A fund balance commitment is further indicated in the budget document as a designation or commitment of the fund (such as for special incentives). Assigned fund balance is established by the PRDH through adoption or amendment of the budget as intended for specific purpose (such as the purchase of fixed assets, construction, debt service, or for other purposes).

<u>Future Adoption of Accounting Pronouncements</u>

1. Future Adoption of Governmental Accounting Standards Board (GASB) Statements – Postponed One Year

The Governmental Accounting Standards Board issued the following pronouncements that have effective dates after June 30, 2018. The PRDH is currently evaluating its accounting practices to determine the potential impact on the financial statements for the GASB Statements. As per GASB Statement No. 95 the effective dates of certain provisions contained in the following pronouncements are postponed by one year.

<u>GASB Statement No. 83, *Certain Asset Retirement Obligations*</u>. This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants.

Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

This Statement requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred. The best estimate should include probability weighting of all potential outcomes, when such information is available or can be obtained at reasonable cost. If probability weighting is not feasible at reasonable cost, the most likely amount should be used. This Statement requires that a deferred outflow of resources associated with an ARO be measured at the amount of the corresponding liability upon initial measurement.

This Statement requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually. In addition, it requires a government to evaluate all relevant factors at least annually to determine whether the effects of one or more of the factors are expected to significantly change the estimated asset retirement outlays. A government should remeasure an ARO only when the result of the evaluation indicates there is a significant change in the estimated outlays. The deferred outflows of resources should be reduced and recognized as outflows of resources (for example, as an expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset.

A government may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter. Additionally, a government may have a minority share of ownership interest in a jointly owned tangible capital asset in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter. In both situations, the government's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of this Statement.

In some cases, governments are legally required to provide funding or other financial assurance for their performance of asset retirement activities. This Statement requires disclosure of how those funding and assurance requirements are being met by a government, as well as the amount of any assets restricted for payment of the government's AROs, if not separately displayed in the financial statements.

This Statement also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. If an ARO (or portions thereof) has been incurred by a government but is not yet recognized because it is not reasonably estimable, the government is required to disclose that fact and the reasons therefor. This Statement requires similar disclosures for a government's minority shares of AROs.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 84, *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. And exception to that requirement is provided for a business-type activity that normally expects to hold custodial assets for three months or less.

This Statement describes four fiduciary funds that should be reported, if applicable, (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

A fiduciary component unit, when reported in the fiduciary fund financial statements of a primary government, should combine its information with its component units that are fiduciary component units and aggregate that combined information with the primary government's fiduciary funds.

This Statement also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

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 defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

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 specifies 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 debts.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The requirements of this Statement will improve financial reporting by providing users of financial statements with essential information that currently is not consistently provided. In addition, information about resources to liquidate debt and the risk associated with changes in terms associated with debt will be disclosed. As a result, users will have better information to understand the effects of debt on a government's future resources flows.

The requirements of this Statement are effective for reporting periods beginning after June15, 2018 *(FY 2018-2019)*. Earlier application is encouraged.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 89, *Accounting for Interest Cost Incurred Before the end of a Construction*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5-22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019 *(FY 2020-2021)*. Earlier application is encouraged. The requirement of this Statement should be applied prospectively.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 90, *Majority Equity Interest—An Amendment of GASB Statements No. 14 and No. 61*. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain component units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. A majority equity method, unless it is held by a special-purpose government engaged only in fiduciary activities, a fiduciary fund, or an endowment (including permanent and term endowments) or permanent fund. Those governments and funds should measure the majority equity interest at fair value.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

For all other holdings of a majority equity interest in a legally separate organization, a government should report the legally separate organization as a component unit, and the government or fund that holds the equity interest should report an asset related to the majority equity interest using the equity method. This Statement establishes that ownership of a majority equity interest in a legally separate organization results in the government being financially accountable for the legally separate organization and, therefore, the government should report that organization as a component unit.

This Statement also requires that a component unit in which a government has a 100 percent equity interest account for its assets, deferred outflows of resources, liabilities, and deferred inflows or resources at acquisition value at the date the government acquired a 100 percent equity interest in the component unit. Transactions presented in flows statements of the component unit in that circumstance should include only transactions that occurred subsequent to the acquisition.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018 *(FY 2019-2020)*. Earlier application is encouraged. The requirements should be applied retroactively, except for the provisions related to (1) reporting a majority equity interest in a component unit and (2) reporting a component unit if the government acquires a 100 percent equity interest. Those provisions should be applied on a prospective basis.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 91, *Conduit Debt Obligations*. The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (1) commitments extended by issuers, (2) arrangements associated with conduit debt obligations, and (3) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation establishing that a conduit debt obligation is not a liability of the issuer, establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations, and improving required note disclosures.

A conduit debt obligation is defined as a debt instrument having all of the following characteristics:

- There are at least three parties involved: (1) an issuer. (2) a third-party obligor, and (3) a debt holder or a debt trustee.
- The issuer and the third-party obligor are not within the same financial reporting entity.
- The debt obligation is not a parity bond of the issuer, nor is it cross-collateralized with other debt of the issuer.
- The third-party obligor or its agent, not the issuer, ultimately receives the proceeds from the debt issuance.
- The third-party obligor, not the issuer, is primarily obligated for the payment of all amounts associated with the debt obligation (debt service payments).

All conduit debt obligations involve the issuer making a limited commitment. Some issuers extend additional commitments or voluntary commitments to support debt service in the event the third party is, or will be, unable to do so.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

An issuer should not recognize a conduit debt obligation as a liability. However, an issuer should recognize a liability associated with an additional commitment or a voluntary commitment to support debt service if certain recognition criteria are met. As long as a conduit debt obligation is outstanding, an issuer that has made an additional commitment should evaluate at least annually whether those criteria are met. An issuer that has made only a limited commitment should evaluate whether those criteria are met when an event occurs that causes the issuer to reevaluate its willingness or ability to support the obligor's debt service through a voluntarily commitment.

This Statement also addresses arrangements—often characterized as leases—that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangement, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

Issuers should not report those arrangements as leases, not should they recognize a liability for the related conduit debt obligations or a receivable for the payments related to those arrangements. In addition, the following provisions apply:

- If the title passes to the third-party obligor at the end of the arrangement, an issuer should not recognize a capital asset.
- If the title does not pass to the third-party obligor and third party has exclusive use of the entire capital asset during the arrangement, the issuer should not recognize a capital asset until the arrangement ends.
- If the title does not pass to the third-party obligor and the third party has exclusive use of only portions of the capital asset during the arrangement, the issuer, at the inception of the arrangement, should recognize the entire capital asset and a deferred inflows of resources. The deferred inflow of resources should be reduced, and an inflow recognized, in a systematic and rational manner over the term of the arrangement.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. Issuers that recognize liabilities related to supporting the debt service of conduit debt obligations also should disclose information about the amount recognized and how the liabilities changed during the reporting period.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2020 (FY 2021-2022). Early application is encouraged.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

<u>GASB Statement No. 92, *Omnibus 2020*</u>. The objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics and includes specific provisions about the following:

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- The requirements related to the effective date of Statement No. 87 and Implementation Guide No. 2019-3, reinsurance recoveries, and terminology used to refer to derivative instruments are effective upon issuance. As per GASB Statement No. 95 the effective date is postponed by additional 18 months.
- Reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan are effective for fiscal years beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- The applicability of Statements No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68, as amended, and No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for postemployment benefits are effective for fiscal years beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- The applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefit arrangements and those related to nonrecurring fair value measurements of assets or liabilities are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- The requirements related to the measurement of liabilities (and assets, if any) associated with AROs in a government acquisition are effective for government acquisitions occurring in reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Terminology used to refer to derivative instruments are effective for reporting periods beginning after June 15, 2020.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 93, *Replacement of Interbank Offered Rates*. Some governments have entered into agreements in which variable payments made or received depend on an interbank offered rate (IBOR)—most notably, the London Interbank Offered Rate (LIBOR). As a result of global reference rate reform, LIBOR is expected to cease to exist in its current form at the end of 2021, prompting governments to amend or replace financial instruments for the purpose of replacing LIBOR with other reference rates, by either changing the reference rate or adding or changing fallback provisions related to the reference rate.

Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, as amended, requires a government to terminate hedge accounting when it renegotiates or amends a critical term of a hedging derivative instrument, such as the reference rate of a hedging derivative instrument's variable payment. In addition, in accordance with Statement No. 87, *Leases*, as amended, replacement of the rate on which variable payments depend in a lease contract would require a government to apply the provisions for lease modifications, including remeasurement of the lease liability or lease receivable.

The objective of this Statement is to address those and other accounting and financial reporting implications that result from the replacement of an IBOR. This Statement achieves that objective by:

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- Providing exceptions for certain hedging derivative instruments to the hedge accounting termination provisions when an IBOR is replaced as the reference rate of the hedging derivative instrument's variable payment
- Clarifying the hedge accounting termination provisions when a hedged item is amended to replace the reference rate
- Clarifying that the uncertainty related to the continued availability of IBORs does not, by itself, affect the assessment of whether the occurrence of a hedged expected transaction is probable
- Removing LIBOR as an appropriate benchmark interest rate for the qualitative evaluation of the effectiveness of an interest rate swap
- Identifying a Secured Overnight Financing Rate and the Effective Federal Funds Rate as appropriate benchmark interest rates for the qualitative evaluation of the effectiveness of an interest rate swap
- Clarifying the definition of reference rate, as it is used in Statement No. 53, as amended
- Providing an exception to the lease modifications guidance in Statement 87, as amended, for certain lease contracts that are amended solely to replace an IBOR as the rate upon which variable payments depend.

The removal of LIBOR as an appropriate benchmark interest rate is effective for reporting periods ending after December 31, 2021. All other requirements of this Statement are effective for reporting periods beginning after June 15, 2020. Earlier application is encouraged.

As per GASB Statement No. 95 the effective date is postponed by additional one year.

2. Future Adoption of Governmental Accounting Standards Board (GASB) Statements – Postponed by Eighteen Months

The Governmental Accounting Standards Board issued the following pronouncements that have effective dates after June 30, 2018. The PRDH is currently evaluating its accounting practices to determine the potential impact on the financial statements for the GASB Statements. As per GASB Statement No. 95 the effective dates of certain provisions contained in the following pronouncements are postponed by eighteen months.

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 receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

DEFINITION OF A LEASE

A lease is defined as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. Examples of nonfinancial assets include buildings, land, vehicles, and equipment. Any contract that meets this definition should be accounted for under the lease's guidance, unless specifically excluded in this Statement.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

LEASE TERM

The lease term is defined as the period during which a lessee has a noncancelable right to use an underlying asset, plus the following periods, if applicable:

a. Periods covered by a lessee's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option

b. Periods covered by a lessee's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessee will exercise that option

c. Periods covered by a lessor's option to extend the lease if it is reasonably certain, based on all relevant factors, that the lessor will exercise that option

d. Periods covered by a lessor's option to terminate the lease if it is reasonably certain, based on all relevant factors, that the lessor will not exercise that option. A fiscal funding or cancellation clause should affect the lease term only when it is reasonably certain that the clause will be exercised.

Lessees and lessors should reassess the lease term only if one or more of the following occur:

a. The lessee or lessor elects to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would not exercise that option.

b. The lessee or lessor elects not to exercise an option even though it was previously determined that it was reasonably certain that the lessee or lessor would exercise that option.

c. An event specified in the lease contract that requires an extension or termination of the lease takes place.

SHORT-TERM LEASES

A short-term lease is defined as a lease that, at the commencement of the lease term, has a maximum possible term under the lease contract of 12 months (or less), including any options to extend, regardless of their probability of being exercised. Lessees and lessors should recognize short-term lease payments as outflows of resources or inflows of resources, respectively, based on the payment provisions of the lease contract.

LESSEE ACCOUNTING

A lessee should recognize a lease liability and a lease asset at the commencement of the lease term, unless the lease is a short-term lease, or it transfers ownership of the underlying asset. The lease liability should be measured at the present value of payments expected to be made during the lease term (less any lease incentives), the lease liability, plus any payments made to the lessor at or before the commencement of the lease term and certain direct costs.

A lessee should reduce the lease liability as payments are made and recognize an outflow of resources (for example, expense) for interest on the liability. The lessee should amortize the lease asset in a systematic and rational manner over the shorter of the lease term or the useful life of the underlying asset. The notes to financial statements should include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

LESSSOR ACCOUNTING

A lessor should recognize a lease receivable and a deferred inflow of resources at the commencement of the lease term, with certain exceptions for leases of assets held as investments, certain regulated leases, short-term leases, and leases that transfer ownership of the underlying asset. A lessor should not derecognize the asset underlying the lease. The lease receivable should be measured at the present value of lease payments expected to be received during the lease term. The deferred inflow of resources should be measured at the value of the lease receivable plus any payments received at or before the commencement of the lease term that relate to future periods.

A lessor should recognize interest revenue on the lease receivable and an inflow of resources (for example, revenue) from the deferred inflows of resources in a systematic and rational manner over the term of the lease. The notes to financial statements should include a description of leasing arrangements and the total amount of inflows of resources recognized from leases.

CONTRACTS WITH MULTIPLE COMPONENTS AND CONTRACT COMBINATIONS

Generally, a government should account for the lease and nonlease components of a lease as separate contracts. If a lease involves multiple underlying assets, lessees and lessors in certain cases should account for each underlying asset as a separate lease contract. To allocate the contract price to different components, lessees and lessors should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment, or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable.

If determining a best estimate is not practicable, multiple components in a lease contract should be accounted for as a single lease unit. Contracts that are entered into at or near the same time with the same counterparty and that meet certain criteria should be considered part of the same lease contract and should be evaluated in accordance with the guidance for contracts with multiple components.

LEASE MODIFICATIONS AND TERMINATIONS

An amendment to a lease contract should be considered a lease modification, unless the lessee's right to use the underlying asset decreases, in which case it would be a partial or full lease termination. A lease termination should be accounted for by reducing the carrying values of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflows of resources by the lessor, with any difference being recognized as a gain or loss. A lease modification that does not qualify as a separate lease should be accounted for by remeasuring the lease liability and adjusting the related lease asset by a lessee and remeasuring the lease receivable and adjusting the related deferred inflows of resources by a lessor.

SUBLEASES AND LEASEBACK TRANSACTIONS

Subleases should be treated as transactions separate from the original lease. The original lessee that becomes the lessor in a sublease should account for the original lease and the sublease as separate transactions, as a lessee and lessor, respectively.

A transaction qualifies for sale-leaseback accounting only if it includes a sale. Otherwise, it is a borrowing. The sale and lease portions of a transaction should be accounted for as separate sale and lease transactions, except that any difference between the carrying value of the capital asset that was sold and the net proceeds from the sale should be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the lease. A lease-leaseback transaction should be accounted for as a net transaction. The gross amounts of each portion of the transaction should be disclosed.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019 *(FY 2020-2021)*. Earlier application is encouraged.

As per GASB Statement No. 95 the effective date is postponed by additional eighteen months.

3. Future Adoption of Governmental Accounting Standards Board (GASB) Statements

The Governmental Accounting Standards Board issued the following pronouncements that have effective dates after June 30, 2019. The PRDH is currently evaluating its accounting practices to determine the potential impact on the financial statements for the GASB Statements.

GASB Statement No. 94, *Public-Private and Public-Public Partnerships and Availability Payment Arrangements*. The primary objective of this Statement is to improve financial reporting by addressing issues related to public-private and public-public partnership arrangements (PPPs). As used in this Statement, a PPP is an arrangement in which a government (the transferor) contracts with an operator (a governmental or nongovernmental entity) to provide public services by conveying control of the right to operate or use a nonfinancial asset, such as infrastructure or other capital asset (the underlying PPP asset), for a period of time in an exchange or exchange-like transaction. Some PPPs meet the definition of a service concession arrangement (SCA), which the Board defines in this Statement as a PPP in which (1) the operator collects and is compensated by fees from third parties; (2) the transferor determines or has the ability to modify or approve which services the operator is required to provide, to whom the operator is required to provide the services, and the prices or rates that can be charged for the services; and (3) the transferor is entitled to significant residual interest in the service utility of the underlying PPP asset at the end of the arrangement.

This Statement also provides guidance for accounting and financial reporting for availability payment arrangements (APAs). As defined in this Statement, an APA is an arrangement in which a government compensates an operator for services that may include designing, constructing, financing, maintaining, or operating an underlying nonfinancial asset for a period of time in an exchange or exchange-like transaction.

PPPS

This Statement requires that PPPs that meet the definition of a lease apply the guidance in Statement No. 87, Leases, as amended, if existing assets of the transferor that are not required to be improved by the operator as part of the PPP arrangement are the only underlying PPP assets and the PPP does not meet the definition of an SCA. This Statement provides accounting and financial reporting requirements for all other PPPs: those that either (1) meet the definition of an SCA or (2) are not within the scope of Statement 87, as amended (as clarified by this Statement). The PPP term is defined as the period during which an operator has a noncancelable right to use an underlying PPP asset, plus, if applicable, certain periods if it is reasonably certain, based on all relevant factors, that the transferor or the operator either will exercise an option to extend the PPP or will not exercise an option to terminate the PPP.

A transferor generally should recognize an underlying PPP asset as an asset in financial statements prepared using the economic resources measurement focus. However, in the case of an underlying PPP asset that is not owned by the transferor or is not the underlying asset of an SCA, a transferor should recognize a receivable measured based on the operator's estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership. In addition, a transferor should recognize a receivable for installment payments, if any, to be received from the operator in relation to the PPP. Measurement of a receivable for installment payments should be at the present value of the payments expected to be received during the PPP term. A transferor also should recognize a deferred inflow of resources for the consideration received or to be received by the transferor as part of the PPP. Revenue should be recognized by a transferor in a systematic and rational manner over the PPP term.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

This Statement requires a transferor to recognize a receivable for installment payments and a deferred inflow of resources to account for a PPP in financial statements prepared using the current financial resources measurement focus. Governmental fund revenue would be recognized in a systematic and rational manner over the PPP term.

This Statement also provides specific guidance in financial statements prepared using the economic resources measurement focus for a government that is an operator in a PPP that either (1) meets the definition of an SCA or (2) is not within the scope of Statement No. 87, as amended (as clarified in this Statement). An operator should report an intangible right-to-use asset related to an underlying PPP asset that either is owned by the transferor or is the underlying asset of an SCA. Measurement of the right-to-use asset should be the amount of consideration to be provided to the transferor, plus any payments made to the transferor at or before the commencement of the PPP term, and certain direct costs. For an underlying PPP asset that is not owned by the transferor and is not the underlying asset of an SCA, an operator should recognize a liability measured based on the estimated carrying value of the underlying PPP asset as of the expected date of the transfer in ownership. In addition, an operator should recognize a liability for installment payments, if any, to be made to the transferor in relation to the PPP. Measurement of a liability for installment payments should be at the present value of the payments expected to be made during the PPP term. An operator also should recognize a deferred outflow of resources for the consideration provided or to be provided to the transferor as part of the PPP. Expense should be recognized by an operator in a systematic and rational manner over the PPP term.

This Statement also requires a government to account for PPP and non-PPP components of a PPP as separate contracts. If a PPP involves multiple underlying assets, a transferor and an operator in certain cases should account for each underlying PPP asset as a separate PPP. To allocate the contract price to different components, a transferor and an operator should use contract prices for individual components as long as they do not appear to be unreasonable based on professional judgment or use professional judgment to determine their best estimate if there are no stated prices or if stated prices appear to be unreasonable. If determining the best estimate is not practicable, multiple components in a PPP should be accounted for as a single PPP.

This Statement also requires an amendment to a PPP to be considered a PPP modification, unless the operator's right to use the underlying PPP asset decreases, in which case it should be considered a partial or full PPP termination. A PPP termination should be accounted for by a transferor by reducing, as applicable, any receivable for installment payments or any receivable related to the transfer of ownership of the underlying PPP asset and by reducing the related deferred inflow of resources. An operator should account for a termination by reducing the carrying value of the right-to-use asset and, as applicable, any liability for installment payments or liability to transfer ownership of the underlying PPP asset. A PPP modification that does not qualify as a separate PPP should be accounted for by remeasuring PPP assets and liabilities.

APAS

An APA that is related to designing, constructing, and financing a nonfinancial asset in which ownership of the asset transfers by the end of the contract should be accounted for by a government as a financed purchase of the underlying nonfinancial asset. This Statement requires a government that engaged in an APA that contains multiple components to recognize each component as a separate arrangement. An APA that is related to operating or maintaining a nonfinancial asset should be reported by a government as an outflow of resources in the period to which payments relate.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The requirements of this Statement are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter. Earlier application is encouraged. As per GASB Statement No. 95 the effective date is postponed by additional one year.

GASB Statement No. 96, *Subscription-Based Information Technology Arrangements*. This Statement provides guidance on the accounting and financial reporting for subscription-based information technology arrangements (SBITAs) for government end users (governments). This Statement (1) defines a SBITA; (2) establishes that a SBITA results in a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability; (3) provides the capitalization criteria for outlays other than subscription payments, including implementation costs of a SBITA; and (4) requires note disclosures regarding a SBITA. To the extent relevant, the standards for SBITAs are based on the standards established in Statement No. 87, *Leases*, as amended.

A SBITA is defined as a contract that conveys control of the right to use another party's (a SBITA vendor's) information technology (IT) software, alone or in combination with tangible capital assets (the underlying IT assets), as specified in the contract for a period of time in an exchange or exchange-like transaction.

The subscription term includes the period during which a government has a noncancelable right to use the underlying IT assets. The subscription term also includes periods covered by an option to extend (if it is reasonably certain that the government or SBITA vendor will exercise that option) or to terminate (if it is reasonably certain that the government of SBITA vendor will *not* exercise that option).

Under this Statement, a government generally should recognize a right-to-use subscription asset—an intangible asset—and a corresponding subscription liability. A government should recognize the subscription liability at the commencement of the subscription term, --which is when the subscription asset is placed into service. The subscription liability should be initially measured at the present value of subscription payments expected to be made during the subscription term. Future subscription payments should be discounted using the interest rate the SBITA vendor charges the government, which may be implicit, or the government's incremental borrowing rate if the interest rate is not readily determinable. A government should recognize amortization of the discount on the subscription liability as an outflow of resources (for example, interest expense) in a subsequent financial reporting periods.

The subscription asset should be initially measured as the sum of (1) the initial subscription liability amount, (2) payments made to the SBITA vendor before commencement of the subscription term, and (3) capitalizable implementation costs, less any incentives received from the SBITA vendor at or before commencement of the subscription term. A government should recognize amortization of the subscription asset as an outflow of resources over the subscription term.

Activities associated with a SBITA, other than making subscription payments, should be grouped into the following three stages, and their costs should be accounted for accordingly:

- Preliminary Project Stage, including activities such as evaluating alternatives, determining needed technology, and selecting a SBITA vendor. Outlays in this stage should be expensed as incurred.
- Initial Implementation Stage, including all ancillary charges necessary to place the subscription asset into service. Outlays in this stage generally should be capitalized as an addition to the subscription asset.
- Operation and Additional Implementation Stage, including activities such as subsequent implementation activities, maintenance, and other activities for a government's ongoing operations related to a SBITA. Outlays in this stage should be expensed as incurred unless they meet specific capitalization criteria.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

In classifying certain outlays into the appropriate stage, the nature of the activity should be the determining factor. Training costs should be expensed as incurred, regardless of the state in which they are incurred.

If a SBITA contract contains multiple components, a government should account for each component as a separate SBITA or no subscription component and allocate the contract price to the different components. If it is not practicable to determine a best estimate for price allocation for some or all components in the contract, a government should account for those components as a single SBITA.

This Statement provides an exception for short-term SBITAs. Short-term SBITAs have a maximum possible term under the SBITA contract if 12 months (or less), including any options to extend, regardless of their probability of being exercised. Subscription payments for short-term SBITAs should be recognized as outflows of resources.

This Statement requires a government to disclose descriptive information abouts its SBITAs other than short-term SBITAs, such as the amount of the subscription asset, accumulated amortization, other payments not included in the measurement of a subscription liability, principal and interest requirements for the subscription liability, and other essential information.

The requirements of this Statement are effective for fiscal years beginning after June 15, 2022, and all reporting period thereafter. Earlier application is encouraged. Assets and liabilities resulting from SBITAs should be recognized and measured using the facts and circumstance that existed at the beginning of the fiscal year in which this Statement is implemented. Governments are permitted, but are not required, to include in the measurement of the subscription asset capitalizable outlays associated with the initial implementation stage and the operation and additional implementation stage incurred prior to the implementation of this Statement.

GASB Statement No. 97, *Certain Component Unit Criteria, and Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans—and amendment of GASB Statements No. 14 and No. 84, and a supersession of GASB Statement No. 32*. The primary objectives of this Statement are to (1) increase consistency and comparability related to the reporting of fiduciary component units in circumstances in which a potential component unit does not have a governing board and the primary government performs the duties that a governing board typically would perform; (2) mitigate costs associated with the reporting of certain defined contribution pension plans, defined contribution other postemployment benefit (OPEB) plans, and employee benefit plans other than pension plans or OPEB plans (other employee benefit plans) as fiduciary component units in fiduciary fund financial statements; and (3) enhance the relevance, consistency, and comparability of the accounting and financial reporting for Internal Revenue Code (IRC) Section 457 deferred compensation plans (Section 457 plans) that meet the definition of a pension plan and for benefits provided through those plans.

This Statement requires that for purposes of determining whether a primary government is financially accountable for a potential component unit, except for a potential component unit that is defined contribution pension plan, a defined contribution OPEB plan, or another employee benefit plan (for example, certain Section 457 plans), the absence of a governing board should be treated the same as the appointment of a voting majority of a governing board if the primary government performs the duties that a governing board typically would perform.

continue

NOTE A – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

This Statement also requires that the financial burden criterion in paragraph 7 of Statement No. 84, *Fiduciary Activities*, be applicable to only defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement No. 67, *Financial Reporting for Pension Plans*, or paragraph 3 of Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, respectively.

This Statement (1) requires that a Section 457 plan be classified as either a pension plan or another employee benefit plan depending on whether the plan meets the definition of a pension plan and (2) clarifies that Statement 84, as amended, should be applied to all arrangements organized under IRC Section 457 to determine whether those arrangements should be reported as fiduciary activities.

This Statement supersedes the remaining provisions of Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans, as amended, regarding investment valuation requirements for Section 457 plans. As a result, investments of all Section 457 plans should be measured as of the end of the plan's reporting period in all circumstances.

The requirements of this Statement that (1) exempt primary governments that perform the duties that a governing board typically performs from treating the absence of a governing board the same as the appointment of a voting majority of a governing board in determining whether they are financially accountable for defined contribution pension plans, defined contribution OPEB plans, or other employee benefit plans and (2) limit the applicability of the financial burden criterion in paragraph 7 of Statement No. 84 to defined benefit pension plans and defined benefit OPEB plans that are administered through trusts that meet the criteria in paragraph 3 of Statement No. 67 or paragraph 3 of Statement No. 74, respectively, are effective immediately.

The requirements of this Statement that are related to the accounting and financial reporting for Section 457 plans are effective for fiscal years beginning after June 15, 2021. For purposes of determining whether a primary government is financially accountable for a potential component unit, the requirements of this Statement that provide that for all other arrangements, the absence of a governing board be treated the same as the appointment of a voting majority of a governing board if the primary government performed the duties that a governing board typically would perform, are effective for reporting periods beginning after June 15, 2021. Earlier application of those requirements is encouraged and permitted by requirement as specified within this Statement.

The Board considered the effective dates for the requirements of this Statement in light of the COVID-19 pandemic and in concert with Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*.

PRDH has not yet determined the effect these statements will have on the PRDH's basic financial statements.

NOTE B – CHANGE IN ACCOUNTING PRINCIPLES

The provisions of the following Governmental Accounting Standards Board (GASB) Statement *are effective immediately*:

GASB Statement No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*. The primary objective of this Statement is to provide temporary relief to governments and other stakeholders in light of the COVID-19 pandemic. That objective is accomplished by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018, and later.

continue

NOTE B – CHANGE IN ACCOUNTING PRINCIPLES – continuation

The effective dates of certain provisions contained in the following pronouncements are postponed by one year:

- Statement No. 83, *Certain Asset Retirement Obligations*
- Statement No. 84, *Fiduciary Activities*
- Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*
- Statement No. 89, *Accounting for Interest Cost Incurred before the End of a Construction Period*
- Statement No. 90, *Majority Equity Interests*
- Statement No. 91, *Conduit Debt Obligations*
- Statement No. 92, *Omnibus 2020*
- Statement No. 93, *Replacement of Interbank Offered Rates*
- Implementation Guide No. 2017-3, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions (and Certain Issues Related to OPEB Plan reporting)*
- Implementation Guide No. 2018-1, *Implementation Guidance Update—2018*
- Implementation Guide No. 2019-1, *Implementation Guidance Update—2019*
- Implementation guide No. 2019-2, *Fiduciary Activities*

The effective dates of the following pronouncements are postponed by 18 months:

- Statement No. 87, *Leases*
- Implementation Guide No. 2019-3, *Leases*.

Earlier application of the provisions addressed in this Statement is encouraged and is permitted to the extent specified in *each* pronouncement as originally issued.

NOTE C – NET POSITION RESTATEMENT

For the year ended June 30, 2018, PRDH adjusted net position for the following concept:

Beginning Net Position, As Previously Reported, June 30, 2018		$ 102,327,302
Adjustments for Accounts Payable Long-Term Unrecognized on Prior Years		
Deferred Outflows - measurement date as of June 30, 2018	$ (6,850,991)	
Net Pension Liability - measurement date as of June 30, 2018	19,688,621	
Deferred Inflows - measurement date as of June 30, 2018	(16,249,007)	
Other postemployment benefit obligation - measurement date as of June 30, 2018	(6,439,762)	
Total Adjustments for Accounts Payable Long-Term unrecognized on prior years		(9,851,139)
Beginning Net Position, As Restated, July 1, 2018		$ 92,476,163

NOTE D – CASH AND CASH EQUIVALENTS, AND RESTRICTED DEPOSITS

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico. The PRDH is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws.

continue

NOTE D – CASH AND CASH EQUIVALENTS, AND RESTRICTED DEPOSITS – continuation

During the year, the PRDH invests its funds in interest bearing bank accounts and certificates of deposit. The PRDH is authorized to deposit only in institutions approved by the Department of the Treasury of the Commonwealth of Puerto Rico. Such deposits should be kept in separate accounts in the name of the PRDH. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of the amounts insured by the Federal Deposit Insurance Corporation. During the year ended June 30, 2019, the PRDH invested its funds in bank accounts bearing interest.

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, PRDH will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Commonwealth, PRDH may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico.

PRDH maintains cash balances in commercial banks. These balances are insured by the Federal Deposit Insurance Corporation up to $250,000. As of June 30, 2019, the uninsured portion of this balance was $9.1 million. Additionally, approximately $119.9 million, are under the custody of the Secretary of the Treasury of Puerto Rico pursuant to Act. No. 230 from July 23, 1974 as amended, known as "Commonwealth of Puerto Rico Accounting Law". The Treasury Department follows the practice of poling cash and cash equivalents under the custody and control of the Secretary of the Treasury. The funds of the PRDH in such pooled cash accounts are available to meet its current operating requirements. No collateral is required to be maintained for these pooled accounts.

Therefore, PRDH management has concluded that on June 30, 2019, the custodial credit risk associated with PRDH cash and cash equivalents is considered low.

Restricted Cash

On June 27, 2001, the PRDH and U.S. Housing and Urban Development (HUD) signed an Amendment to Memorandum of Understanding which required, among other things, the deposit of all residual receipts in a special escrow account. This account is required to maintain collateral in the form of investments to prevent risk of loss to the principal balance. All accrued interest shall be deposited in this account. Also, any profit generated from the sale of multifamily properties, as defined, should be deposited in this account within ten (10) business days after the sale is consummated. The funds deposited in this account shall be used for necessary and eligible activities within the Housing Programs of the PRDH that directly relate to the expansion of the supply of low and moderate-income housing and other initiatives covered in the Housing Program such as; development of lots (Turnkey Lots), construction of housing for sale and construction or rehabilitation of infrastructure which might be needed to facilitate housing for qualified low-income families. Withdrawals from the special escrow account shall only be made upon written authorization of the HUD Director of the Caribbean Multifamily Program Center and by PRDH.

continue

NOTE E – MORTGAGES AND ACCOUNTS RECEIVABLE

Mortgages and accounts receivable as of June 30, 2019, consist of the following:

Mortgages Receivable

Mortgage notes receivable consist of first mortgages arising from the sale of housing units with interest rates ranging from 3.125% to 9%, maturing within a period of two (2) to nineteen (19) years. Due to delinquency of the portfolio as of June 30, 2019, management's opinion is that certain mortgages notes are not collectible and that in order to realize a portion of their value, the housing units will have to be repossessed and subsequently sold. Therefore, a valuation allowance equal to the value of the asset ($2,403,747) was recorded on June 30, 2019.

Description		Amount
Mortgage Notes	$	1,885,718
Other Accounts Receivable		518,029
		2,403,747
Less Valuation Allowance		(2,403,747)
	$	-

Grants and Other Receivables

Grant's receivable on June 30, 2019 consists of federal grants receivable as follows:

Federal Program		Amount
Section 8 Housing Choice Vouchers Program	$	963,283
Sheltering and Temporary Essential Power		152,877,459
Community Development Block Grant Program		5,964,783
Community Development Block Grant Program - Disaster Recovery Program		4,330,120
Continuum of Care Program		9,210
	$	164,144,855

Additionally, the PRDH have accounts receivable from Other State Funds as follows:

Other State Funds		Amount
State Share Matching Funds for the FEMA Recovery Fund	$	1,245,081
Amount due from Assurance Reserve Fund of Partnership Agreement (see Note F)		16,776,514
Amount due from Related Entity (see Note U)		6,091,242
Other		1,626,528
	$	25,739,365

continue

NOTE F – PARTNERSHIP AGREEMENT

On August 1, 2008, the PRDH became a general partner of Vivienda Modernization Holdings 1, S.E. ("the Partnership"), a Puerto Rico civil partnership that was formed on August 1, 2008 to acquire a 100%-member interest in Vivienda Modernization 1, LLC ("the Project Company"), a Puerto Rico limited liability company. The Project Company was formed to acquire, develop, rehabilitate, own, maintain and operate 33 residential rental properties located in Puerto Rico ("the Projects"). The properties are rented to low-income tenants and are operated in a manner necessary to qualify for federal low-income housing tax credits as provided for in Section 42 of the Internal Revenue Code ("IRC").

The investment partnership is Hudson Housing Tax Credit Fund XL LP ("the Investor Limited Partner"). The special limited partner is Hudson SLP XL LLC ("the Special Limited Partner"); a Delaware limited liability company (collectively with the Investor Limited Partner, referred to as the "Limited Partners").

Profits, losses and tax credits are allocated in accordance with the Partnership Agreement. Profits and losses from operations and low-income housing tax credits in any one year shall be allocated 99.98% to the Investor Limited Partner, 0.01% to the Special Limited Partner and 0.01% to the General Partner. As defined in the Partnership Agreement, certain transactions and occurrences warrant special allocations of profits and losses. All other losses shall be allocated to the extent allowable under Section 704(b) of the IRC.

Pursuant to the Partnership Agreement, the Limited Partners are required to provide capital contributions totaling approximately $235 million to the Partnership ("Initial Projected Equity"), subject to potential adjustment based on the amount of low-income housing credits ultimately allocated to the Projects in addition to other potential occurrences as more fully explained in the Partnership Agreement. As of June 30, 2019, the Limited Partners have provided capital contributions totaling $126,636,341.

Pursuant to the Partnership Agreement, the General Partner is required to provide capital contributions totaling $10 to the Partnership. Should the Partnership have no sufficient funds available to pay the outstanding balance of the developer's fee thereof, the General Partner shall be required to provide additional capital contributions to the Partnership in an amount sufficient for the Partnership to pay such balance in full. The General Partner shall have no right or obligation to make any other capital contributions. As of June 30, 2019, the General Partner had provided no capital contributions.

Pursuant to the Partnership Agreement, the Project Company is required to pay an annual management fee of $61,980 to the General Partner for services rendered in connection with the administration of the Partnership's business affairs. The fee shall be adjusted annually by 3% and is payable from gross effective income, as further defined in the Partnership Agreement. To the extent funds are available in the Social Services Subaccount, the Partnership is also required to pay the Puerto Rico Public Housing Authority ("PRPHA") an additional annual fee of $50,000 (refer to Note M for details). The fees are payable in December of each year and shall accrue. As of June 30, 2019, the General Partner has earned and was owed $126,193.

On July 14, 2010, the General Partner and the Limited Partners (collectively, the "Partners") entered into a Memorandum of Understanding ("the MOU"). The MOU details certain mutually agreed-upon resolutions to issues that have arisen during the course of construction and rehabilitation of the Projects, with the expectation of amending and restating the Partnership Agreement. The contemplated resolution include change to certain commitments of the Partners affecting tax credits delivery and the resulting capital to be contributed, as well as various revisions to the respective rights and obligations of the Partners. On December 30, 2010, the Partners entered into the First Amended and Restated Agreement of Partnership.

continue

NOTE F – PARTNERSHIP AGREEMENT – continuation

Assurance Reserve Fund

Pursuant to the Partnership Agreement, the PRDH as general partner shall establish the Assurance Reserve Fund at initial closing in the amount of the initial capital contribution less $4,000,000 (plus any initial capital contribution with respect to the apartment complexes).

Amounts in the Assurance Reserve Fund shall be used, (i) upon the request of the General Partner, subject to the consent of the Special Limited Partner, or (ii) upon the direction of the Special Limited Partner, to meet financial obligations of the General Partner, other than for excess development costs, as provided in the Agreement. As of June 30, 2019, such reserve was maintained in the Partnership. The amount owed to PRDH for the assurance reserve fund as of June 30, 2019, amounted to $16,776,514, presented as Other Accounts Receivable on Self-Contribution Fund.

Deferred Purchase Price Note

Also, on August 7, 2008, the PRDH entered in a loan agreement with Vivienda Modernization 1, LLC ("the Project Company") in the amount of $102,889,957 for the acquisition of 33 residential rental properties ("the Deferred Purchase Price Note").

The Project Company shall make payments equal to the amount of net available capital contributions for the preceding calendar quarter. Net available capital contributions are defined as: (i) the aggregate capital contributions received by the Project Company during the preceding calendar quarter, less (ii) any increase in the Assurance Reserve funded from such capital contributions during the preceding quarter as permitted under the Partnership Agreement, plus (iii) any amount the Project Company no longer needs to maintain the Assurance Reserve.

The terms of the deferred purchase price note are described as set forth below:

Commitment:	$102,889,957
Interest rate:	3.55%
Maturity date:	Later of (i) funding of the last installment of the third capital contribution or (ii) August 7, 2013

The note shall be a full recourse liability of the Project Company; however, none of the Project Company's members have personal liability. As of June 30, 2019, the principal balance outstanding on the deferred purchase price note was $8,754,831 and accrued interest was $2,720,399.

Developer's Fees

Additionally, on August 7, 2008, Vivienda Modernization 1, LLC ("the Project Company") entered into a Master Developer Agreement with the PRDH to perform services in connection with the development, rehabilitation, and modernization of certain housing projects ("Developer Agreement"). Pursuant to the Master Developer Agreement, the PRDH will earn a developer's fee in the amount of $75,082,335 for services performed and to be performed. Payment of the developer's fee shall be subject to the terms and conditions of Section 6(a) (i-iv) of the Developer Agreement. As of June 30, 2019, the Project Company owed PRDH a net amount of $57,035,794 that included a reduction of $14,046,541 as allowance of uncollectible, based on adjustment in accordance with the provision of the Partnership Agreement.

Total amount owed to PRDH amounted to $72,522,474 ($16,618,841 from the Assurance Reserve Fund plus $55,903,633 of Developer's Fees) is presented in the *Statement of Net Position*.

continue

NOTE G – NOTES RECEIVABLE FROM DEVELOPER

On June 4, 2015, the PRDH along with the Puerto Rico Public Housing Administration (PRPHA) and McCormack Baron Salazar, Inc. (the Developer), a Missouri corporation acting through its whole-owned subsidiary McCormack Baron Puerto Rico Developer, LLC (the Developer), entered into three Master Development Agreements (MDA) to transform certain developments (redevelopment) through a development strategy. In accordance with the strategy, the Developer prepared an Implementation Plan which was approved by the PRDH and the PRPHA. The three redevelopments were: Las Gladiolas Public Housing Development, Puerta de Tierra Housing Development and José Gautier Benítez Public Housing, which include two projects, a multi-family project and an elderly project.

PRPHA, the public housing authority for the Commonwealth of Puerto Rico, has submitted, and HUD has approved, a mixed-finance proposal for each of these redevelopments in accordance with Section 35 of the U.S. Housing Act of 1937. The mixed-finance provides for a U.S. Department of Housing and Urban Development (HUD)'s operating subsidy for certain of the units and the use of federal development funds known as capital funds made available for the development and construction.

The PRPHA's housing commitment for the projects is approximately $65 million. The Developer will review and pursue funding sources. Developer shall seek proposals from prospective investors in the Low-Income Housing tax credit allocated to the rental phase of the project.

Memorandum of Understanding

On June 23, 2016, the PRDH entered into a Memorandum of Understanding (the "MOU") with the PRPHA, in which the PRPHA agrees to provide support and assistance to the PRDH in furtherance of the PRPHA's purpose and objectives, as part of this redevelopment strategy. In connection with this MOU, the PRPHA performed the disbursements of funds to the Developer, accounting services and other management assistance related to the redevelopments and the re-occupancy of the projects.

Lease

With the approval of HUD, the PRPHA transferred the redevelopment properties to the PRDH, so that the same could be redevelop as a mixed-finance projects pursuant to 24 CFR § 905 Subpart F. The PRDH in turn entered into leases with the Developer. The term of the leases is for 75 years, but such termination could be advanced to an earlier date by express, written agreement of the parties, or by operation of law. Upon termination of the leases, the improvements and equipment will be automatically transferred in favor of the PRDH. The PRDH in turn will transfer the projects to the PRPHA.

Predevelopment Loan

On September 10, 2015, the PRDH entered into a predevelopment loan and advance of funds agreement with the Developer. The PRDH used the funds to provide to the Developer funds advances under a predevelopment loan for certain eligible costs to be incurred by the Developer as described in the predevelopment budget, upon approval by HUD. The predevelopment budget, as amended, was $6,376,190 and the source of the funds was as follow:

Department of Housing	$ 2,325,295
McCormack Baron PR Developer, LLC	2,325,295
Department of Housing (for Developer Overhead)	1,725,600
	$ 6,376,190

continue

NOTE G – NOTES RECEIVABLE FROM DEVELOPER – continuation

The PRPHA agreed to make a loan to Developer in a principal amount of up to 50% of third-party costs incurred by Developer (Developer will pay the other 50%) and for 100% of the predevelopment developer overhead in accordance with the predevelopment budget. The predevelopment loan shall not bear interest and advances will be made by the PRPHA on the PRDH's behalf. On June 30, 2019, the account receivable for advances made to the Developers for predevelopment costs of the projects amounted to $3,837,863 (see Note U).

The principal amount of the predevelopment loan attributable to each of the developments shall mature and be due and payable on the earlier of (a) execution of the development predevelopment loan agreement for each development; (b) upon closing for such development, or (c) the termination of the corresponding master development agreement, as provided in the loan agreement.

Construction Loans

PRDH agrees to make available to the Developer, from time to time, as construction of the developments progresses, advances under a non-revolving line of credit facilities. The PRPHA will make available certain funds to the PRDH for the PRDH to lend to the Developer certain permanent loans. Additionally, the Developer will request from other national banking association to lend them certain construction loans. The PRDH's housing commitment for the projects is approximately $65 million. The Developer will review and pursue funding sources. Developer shall seek proposals from prospective investors in the Low-Income Housing tax credit allocated to the rental phase of the project.

On the conversion date and to the extent that the Developer shall have paid in full to the PRDH all interest accrued under the construction loan facility, the outstanding principal amount of the advances shall be converted into a term note. The unpaid balances of these obligations shall bear interest from the date of the leasehold mortgage note until full payment thereof, at an annual rate equal to six hundred basis (600) points per annum.

The Developer will request additional funds from other private national banking institutions, as needed.

Once the construction loan facilities are converted into term loans, the loans aggregate unpaid principal amounts, plus any accrued and unpaid interests shall become due and payable on the 75th anniversary of the first day of the month immediately succeeding the closing date; or the date on which an early termination provision under ground lease is exercised by the parties; or the date of occurrence of an event of default. On June 30, 2019 total Note Receivable from Developer and accrued interest receivable amount to $33,900,256 and $1,995,560, respectively, segregated by project as follow:

Project	Note Receivable	Accrued Interests	Total
Las Gladiolas Public Housing	$ 11,291,288	$ 1,100,000	$ 12,391,288
Puerta de Tierra Public Housing	13,692,554	801,000	14,493,554
Gautier Benitez - Multifamily	5,651,744	61,071	5,712,815
Gautier Benitez – Elderly Home	3,264,670	33,489	3,298,159
Total	**$ 33,900,256**	**$ 1,995,560**	**$ 35,895,816**

continue

NOTE H – HOUSING UNITS AND LAND LOTS HELD FOR SALE OR LEASE

The PRDH has an inventory of land lots held for sale or lease. This inventory was valued at a nominal amount of $1 per land lot since it will be granted to low income families at no cost. For the year ended on June 30, 2019, the value of the land lots held for sale or lease was $39,773 under the governmental activities.

In June 2015, the Governmental Accounting Standards Board (GASB) issue Statement No. 72, *Fair Value Measurement and Application*. This Statement requires government to use valuation techniques that are appropriate under the circumstances and for which sufficient data are available to measure fair value. With the adoption of the Statement, Housing units and lots held for sale are stated using a financial forecast developed by PRDH, due to the absent of reasonably available information's that indicates that market participants would use different assumption

This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are inputs–other than quoted prices–included within Level 1 that are observable for the asset or liability, either directly or indirectly. Finally, Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security.

PRDH apply Level 3 as the measure of evaluating its fair values for the Housing Units and Lots Held for Sale base on the nature of the assets being evaluated. PRDH does not record all changes in estimated realizable fair value of all the housing units and lots held for sale due to Level 3 inputs are difficult to obtain on a regular basis and require verification from an outside party, and the high cost of appraisal services versus the short time benefit of one year of such services.

The PRDH has an inventory of housing units under the Sale and Acquisition fund. Land lots held for sale consist of real estate properties including parcels of land, houses and apartments. These properties are stated at their fair value determined by the application of a financial forecast base on the changes in Purchase-only House Price Index prepared by management.

The PRDH has an inventory of housing units under the Sale and Acquisition fund for a total $33,598,468, measured at fair value as of June 30, 2019, as follows:

Description	Amount
Housing Units and Land Lots	$ 38,559,107
Adjustment to FMV	(4,960,639)
Housing Units and Lots Held for Sale, Net	$ 33,598,468

Land lots held for sale consist of real estate properties including parcels of land, houses and apartments. These properties are stated at their fair value determined by the application of a financial forecast base on the changes in Purchase-only House Price Index prepared by management.

On August 3, 2000, the Legislature of the Commonwealth of Puerto Rico enacted Act No. 383 establishing that "Finca San Patricio" was to be retained for the development of a public urban forest. It is presented as a Restricted Land Lot.

continue

NOTE I – CAPITAL ASSETS

A summary of the activity of capital assets for the governmental activities group follows:

Description	Beginning Balance	Additions	Retirements	Ending Balance
Capital Assets not being depreciated:				
Land	$ 850,831	$ -	$ -	$ 850,831
Capital Assets Depreciated:				
Vehicles, Fixtures and Equipment	6,202,599	442,562	-	6,645,161
Parking and Building	5,164,129	-	-	5,164,129
Building	30,000,000	-	-	30,000,000
Building Improvements	21,525,268	-	-	21,525,268
Construction in Progress	-	339,924	-	339,924
Total Capital Assets Before Depreciation	62,891,996	782,486	-	63,674,482
Less Accumulated Depreciation	(25,259,368)	(2,143,839)	-	(27,403,207)
Total Depreciable Capital Assets (Net)	37,632,628	(1,361,353)	-	36,271,275
CAPITAL ASSETS NET	$ 38,483,459	$ (1,361,353)	$ -	$ 37,122,106

The depreciation expense is recorded as general and administrative function in the Government Wide financial statements.

NOTE J – DEFERRED OUTFLOWS / INFLOWS OF RESOURCES

Pursuant to GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* the PRDH may recognized deferred outflows of resources in the government-wide and fund statements. These items are a consumption of net position by the PRDH that is applicable to a future reporting period. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. The PRDH has items that are reportable on the Government-wide *Statement of Net Position* that are relates to outflows/inflows from changes in the Net Pension Liability (Note M).

Under the modified accrual basis of accounting, it is not enough that revenue is earned; it must also be available to finance expenditures of the current period. Governmental funds *Balance Sheet* do not report *Deferred Outflows/Inflows of Resources*.

At the end of the current fiscal year, the various components of *Deferred Outflows/Inflows of Resources* reported in the basic financial statements were as follows:

Governmental Activities:	
Deferred Outflows of Resources	
Contributions to Employees' Retirement System	$ 9,597,059
Deferred Inflows of Resources	
Unamortized Investment in Employees' Retirement System	$ 17,904,763

continue

NOTE K – SHORT AND LONG-TERM OBLIGATIONS

Short and long-term obligations as of June 30, 2019, are composed of the followings:

Short-term obligation consists of a line of credit to the Puerto Rico Housing Finance Authority (PRHFA) for the Santurce Rehabilitation Plan, through the approval by corporate resolutions during fiscal year ended June 30, 2002. The loan is secured by properties owned by another governmental agency. The credit line carries interest based on quarterly variable labor rate plus 1.25%, with a minimum annual interest rate of six percent (6%). Principal and interest are payable annually. The line of credit was due on March 15, 2009. Management is on the process of refinancing the balance due.	$ 5,230,118
Note payable to Federal Emergency Management Agency (FEMA) in seventy-two monthly cash payments of $141,000, starting July 31, 2017, and continuing every month on the same date until the entire debt and all related charges are paid. The first payment is for $241,000, which includes an initial down-payment of $100,000. The payment plan includes interest accrued prior to the first payment date, plus interest set at 1% per year, pursuant to U.S. Department of Treasury regulations. If the PRDH fails to make full payment within thirty (30) days of the date payment is due, the debt is delinquent, and the entire balance is due immediately. Refer to note below for additional information.	6,581,592
Note payable to the Government Development Bank of Puerto Rico (GDB) in monthly installments of $250,000, including principal, escrow and interest on a quarterly variable rate of .75% over LIBOR. The note is pledged by an assignment of the rent agreements of two (2) tenants.	8,976,243
Total Notes Payable	20,787,953
Less Current Portion	(11,127,393)
Note Payable, Long-Term Portion	$ 9,660,560

On June 30, 2019, scheduled aggregate principal and interest maturities of notes payable were approximately as follows (these amounts exclude the $5,230,118 owed to PRHFA that was due and is on the process of refinancing):

Year Ending June 30,	Principal	Interest	Total
2020	$ 5,897,275	$ 225,891	$ 6,123,166
2021	3,921,317	172,149	4,093,466
2022	4,107,767	127,060	4,234,828
2023	1,631,476	8,646	1,640,122
Total	$ 15,557,835	$ 533,747	$ 16,091,582

continue

NOTE L – COMPENSATED ABSENCES

Total vested pay benefits accrued for compensated absences on June 30, 2019, amount to $3,895,096 which activity for the year ended June 30, 2019, is summarized as follows:

Beginning Balance	Increase	Decrease	Ending Balance	Due Within One (1) Year	Due After One (1) Year
$ 1,266,906	$ 633,309	$ (440,787)	$ 1,459,428	$ 124,713	$ 1,334,715

NOTE M – EMPLOYEES' RETIREMENT PLAN

Substantially all full-time employees of the PRDH participate in the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS). The Employees Retirement System is a statutory trust created by Act No. 447 of May 15, 1951, as amended (Act 447) and a component unit of the Commonwealth.

On April 4, 2013, the Governor of Puerto Rico, signed into law Act No. 3 of 2013, which represents a comprehensive reform of the ERS Act No. 3 became effective on July 1, 2013 and amended the provisions of the different benefit structures under the ERS as further discussed below.

Members who had entered the Employees Retirement System before January 1, 2000 participated in a defined benefit program. Members who began to participate prior to April 1, 1990 (Act 447 Participants) were entitled to the highest benefits structure, while those who began to participate on or after April 1, 1990 (Act 1 Participants) were subject to a longer vesting period and a reduced level of benefits, as provided by Act No. 1 of February 16, 1990 (Act 1 of 1990).

In 1999, Act 447 was amended to close the defined benefit program for new participants and, prospectively, establish a new benefit structure similar to a cash balance plan (this new benefit structure is referred to as System 2000). Members who entered the ERS on or after January 1, 2000 (System 2000 Participants) participate solely in System 2000. Act 3-2013 amended the law to eliminate the lump sum distribution alternative and substitute it for a life annuity payable to the System 2000 Participant. System 2000 Participants do not benefit from any employer contributions. Instead, employer contributions made on account of System 2000 Participants are used to reduce the accumulated unfunded pension benefit obligation of the ERS.

System 2000 is not a separate plan as there are no separate accounts for System 2000 Participants. Contributions received from System 2000 Participants are pooled and invested by the ERS together with the assets corresponding to the defined benefit structure of Act 447 and Act 1 of 1990 and the defined contribution structure of System 2000, as amended by Act 3-2013, will be paid from the same pool of assets of the ERS.

Retirement and related benefits provided by the ERS, and required contributions to the ERS by employers and employees, are determined by law rather than by actuarial requirements. As of July 1, 2011, after the adoption of Act 116 of July 6, 2011 (Act 116), the statutory employer contribution for the ERS increased from a minimum of 9.275% to a minimum of 10.275% of covered payroll, and will continue to increase annually until fiscal year 2021. The employer contribution rate for fiscal year 2015 is 13.275%.

Required employee contributions for the ERS vary according to how the individual employee's retirement benefits are coordinated with social security benefits. Act 3-2013 increased the employee contribution from 8.275% to 10% of covered payroll.

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

The ERS provides basic benefits under the defined benefit program principally consisting of a retirement annuity and death and disability benefits (collectively referred to herein as Basic System Pension Benefits). The ERS also administers benefits granted under various special laws that have provided additional benefits for the retirees and beneficiaries (collectively referred to herein as System Administered Pension Benefits). The System Administered Pension Benefits include, among others, additional minimum pension, death and disability benefits, ad-hoc cost-of-living adjustments and summer and Christmas bonuses. Act 3-2013 and Act 160-2013 amended the various laws providing some of these System Administered Pension Benefits to reduce some of the amounts payable to existing retirees while eliminating the benefits for all future retirees (those retiring after June 30, 2013 and July 31, 2014).

The System Administered Pension Benefits are funded on a pay-as-you-go basis by the participating employers, including the PRDH. The System Administered Pension Benefits corresponding to former employees of the PRDH are obligations of the PRDH. Most of the funds used to cover the System Administered Pension Benefits for other covered employees are required to be paid by the Commonwealth.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2016 (most recently available) reflects a fiduciary net position (deficit) of $1,265,885,000, total pension liability of $36,432,873,000 and a net pension liability of $37,698,758,000.

Statement No. 68 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27 (GASB 68) became effective for the year ended June 30, 2015. This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the ERS.

For the year ended June 30, 2019 the PRDH recognized pension expense of $6,464,603 and as of that date reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Description	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences Between Expected and Actual Experience	$ 45,142	$ 1,182,603
Changes of Assumptions	8,735,477	6,800,912
Net Difference Between Projected and Actual Investments Earnings on Pension Plan Investments	-	390,329
Changes in Proportions	-	9,530,919
Current Year Employer's Contribution	816,440	-
	$ 9,597,059	$ 17,904,763

The amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

Year Ending June 30,	Collective Data	Proportional Share
2018	$ 331,506,706	$ (13,221,588)
2019	379,113,154	(15,120,292)
2020	391,332,952	(15,607,658)
2021	(155,731,936)	6,211,107
2022	(737,920,670)	29,430,727
	$ 208,300,206	$ (8,307,704)

Actuarial Methods and Assumptions

The plan's actuarial cost method is the entry age normal method. Under this method, a projected benefit is determined at each active participant's assumed retirement age assuming future compensation increases. The plan's normal cost is the sum of each active participant's annual cost for the current year of service determined such that, if it were calculated as a level percentage of his compensation each year, it would accumulate at the valuation interest rate over his total prior and future years of service to his assumed retirement date into an amount sufficient to fund his projected benefit. The plan's accrued liability is the sum of (a) the accumulation of each active participant's normal costs attributable to all prior years of service plus (b) the present value of each inactive participant's future benefits.

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.

As per ERS Actuarial Valuation Report as of June 30, 2017, future actuarial measurement may differ significantly from the current measurements used in the report mentioned above due to factors such as the following: plan experience differing from actuarial assumption; future changes in the actuarial assumptions; Increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as potential additional contribution requirements due to changes on the plan funded status); and changes in the plan provisions or accounting standards. The significant actuarial assumptions used to determine the standardized measure of the pension benefits obligation as of June 30, 2016 are summarized below.

- Investment Return: Not applicable due to pay-as-you-go funding.
- Municipal Bond Rate: 3.58% per annum (Bond Buyer General Obligation 20-Bond Municipal Bond Index)
- GASB 67 discount rate: 3.58% per annum
- Compensation Increases: 3.0% per year. No compensation increases are assumed until July 1, 2021 as a result of the Act 3-2017 four-year extension of the Act 66-2014 salary freeze and the current general economy. Based on professional judgment and System input.
- Defined Contribution Hybrid Contribution Account: Member contributions to the Defined Contribution Hybrid Contribution Account are assumed to be 10.0% of Compensation. Defined Contribution Hybrid Contribution Accounts are assumed to grow prospectively using a 5.24% annual investment return (80% of the net investment return assumption as shown above).

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

- Basis for demographic assumptions: The post-retirement health and disabled mortality assumptions used were based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. Most other demographic assumptions used were based on a 2009 experience study using data as of June 30, 2003, June 30, 2005, and June 30, 2007. Certain demographic assumptions (e.g. termination and retirement) were impacted by the Act 3 pension reforms and were revised based on the new retirement eligibility and expected future experience.

- Termination: Withdrawal rates vary by employment category, age, and service.

- Retirement: Rates of retirement vary by employment category, Act, age and years of Creditable Service, and whether the member was eligible to retire as of June 30, 2013 for Act 447, Act 1, and System 2000 members.

- Disability: Rates are based on the six-month elimination period rates in the 1987 Commissioners Group Disability Table, as adjusted. 100% of disabilities occurring while in active service are assumed to be occupational for members covered under Act 127.

- Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.

- Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of 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 the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis, which reflects mortality improvements both before and after the measurement date.

- Post-retirement Disabled Mortality: Rates which vary by gender are assumed for disabled retirees based on a study of 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 CIP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

- Marriage: 100% of current active members covered under Act 127 who die in service or become disabled are assumed to have qualifying beneficiaries receiving the maximum benefits possible, which are approximated by a spouse with males 4 years older than females.

- Actuarial Cost Method: The plan's actuarial cost method is the entry age normal method.

- Asset Value Method: Market value of assets.

- Inflation Rate: Not applicable.

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

- Additional Uniform Contribution - Not applicable. Eliminated July 1, 2017 by Act 106-2017.

The total pension liability was determined by an actuarial valuation as of July 1, 2016, calculated based on the discount rate and actuarial assumptions as shown above and was then projected forward to June 30, 2017. There have been no significant changes between the valuation date of July 1, 2016 and the fiscal year end. Any significant changes during this period must be reflected as prescribed by GASB 67. Covered Payroll is as of July 1, 2016. The tax-free municipal bond index of 3.58% as of June 30, 2017, was used as the discount rate in the determination of the Total Pension Liability as of June 30, 2017.

Net Pension Liability	Amount	Proportional Share
Total Pension Liability	$ 32,109,294,000	$ 62,704,017
Fiduciary Net Position	$ (2,108,880,000)	$ (4,118,286)
Total Net Pension Liability	$ 34,218,174,000	$ 66,822,303
Fiduciary Net Position as a % of Total Pension Liability	-6.57%	-6.57%
Covered Employee Payroll	$ 3,344,197,000	$ 6,530,651
Net Pension Liability as a % of Covered Employee Payroll	1023.21%	1023.21%

Discount Rate

The plan's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that results in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the plans' fiduciary net position is projected to be sufficient to make projected benefit payments, and the municipal bond rate applied to benefit payments, to the extent that the plan's fiduciary net position is not projected to be sufficient. The discount rate on June 30, 2016 and 2017, was as follow:

	June 30, 2016	June 30, 2017
Discount Rate	2.85%	3.58%
Long-term expected rate of return net of investment expense	6.55%	N/A
Municipal bond rate *	2.85%	3.58%

* Bond Buyer General Obligation 20-Bond Municipal Bond Index

According to Paragraph 30 of Statement 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. Using this lower discount rate has resulted in a slightly higher Total Pension Liability and Net Pension Liability. The Net Pension Liability of $66,822,303 was determined as follows:

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

Change in Net Pension Liability	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability	Proportional Share
Beginning Balance	$ 36,432,873,000	$ (1,265,885,000)	$ 37,698,758,000	$ 73,619,295
Change for the year:				
Service Cost	628,025,000	-	628,025,000	1,226,427
Interest on Total Pension Liability	1,034,186,000	-	1,034,186,000	2,019,590
Effect of Plan Changes	-	-	-	-
Effect of Economic/Demographic (Gains) of Loses	(248,414,000)	-	(248,414,000)	(485,111)
Effect of Assumptions Changes or Inputs	(4,179,110,000)	-	(4,179,110,000)	(8,161,095)
Benefit Payments	(1,558,266,000)	(1,558,266,000)	-	-
Administrative Expenses	-	(26,142,000)	26,142,000	51,051
Other Expenses	-	(394,324,000)	394,324,000	770,048
Costs of Bonds	-	(198,084,000)	198,084,000	386,825
Member Contributions	-	320,095,000	(320,095,000)	(625,091)
Net Investment Income	-	92,188,000	(92,188,000)	(180,028)
Employer Contributions	-	921,538,000	(921,538,000)	(1,799,608)
Ending Balance	$ 32,109,294,000	$ (2,108,880,000)	$ 34,218,174,000	$ 66,822,303

Sensitivity of the PRDH proportionate share of the net pension asset to changes in the discount rate

The following presents the PRDH proportionate share of the net pension asset calculated using the discount rate of 2.85 percentage, as well as what the PRDH's proportionate share of the net pension asset or net pension liability would be if it were calculated using a discount rate that is one percentage lower (1.85 percent) or one percentage point higher (3.85 percent) than the current rate:

	At 1 percent decrease (2.58%)	At current discount rate (3.58%)	At 1 percent increase (4.58%)
Net Pension Liability	$ (38,801,889,000)	$ (34,218,147,000)	$ (30,527,686,000)
Proportional Share	$ (75,773,523)	$ (66,822,250)	$ (59,615,404)

Fiscal Plan for Puerto Rico

The Fiscal Plan for Puerto Rico (last revised October 23, 2018) was approved by the Puerto Rico Fiscal Board (a body created by the enactment of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA")). Section 16.2.2 anticipates a 10% reduction in aggregate benefit payments, with an implementation date of July 1, 2019. As legislation has not been passed yet, these potential reductions are not reflected in this June 30, 2017 valuation. The Fiscal Plan does reflect that PRGERS will be funded on a pay-as-you-go basis once assets are exhausted.

Pay-As-You-Go Funding

Operating a retirement system on a "pay-go" charge basis may be conceptually simple but can be very difficult in practice when the plan sponsor's current funds and ability to rely on reserves are limited or non-existent. While the valuation of ERS liabilities for financial reporting purposes is conducted on an annual basis in arrears, statutory benefit payments vary continuously and respond instantaneously to emerging events. There are also administrative expenses incurred continuously, and very significant Pension Obligation Bond debt service.

continue

NOTE M – EMPLOYEES' RETIREMENT PLAN - continuation

Disbursements will experience natural variation due to emerging demographic experience and could also be greatly impacted by specific management decisions, such as an early retirement incentive program or other workforce reduction. A major issue that needs to be addressed is determining what the process of budgeting for "pay-go" funding will be. While expected "pay-go" amount can be set at the time of budgeting for an upcoming fiscal year, disbursements can vary from expectations during the fiscal year under the following circumstances:

- If the budget is set based on expected contributions and disbursements, in the event of adverse experience during the fiscal year, should provide for additional funds from the sponsoring employers.
- If the ERS be permitted to develop a budget request of a "pay-go" amount for the fiscal year that includes a margin to provide a buffer against adverse outcomes.
- And how would the impacts of specific management decisions be handled.

There are certainly many more operational details to be considered. "Pay-go" operation is a complex issue that requires careful though and planning, constant monitoring, and the ability to respond to emerging events quickly.

Pension Plan Fiduciary Net Position

As per June 30, 2016 Actuarial Valuation Report issued on November 7, 2017, the Actuaries state: "**PRGERS net assets became negative in the 2014-2015 fiscal year. PRGERS gross assets as of June 30, 2017 are less than one year of expected benefit payments."**

NOTE N – VOLUNTARY TERMINATION BENEFITS

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the PRDH. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited service in the Retirement System and will consist of biweekly benefits ranging from 37.5% to 50 % of each employee' salary, as defined. In this early retirement benefit program, the PRDH will make the employee and the employer contributions to the Retirement System and pay the corresponding pension until the employee complies with the requirements of age and 30 years of credited service in the Retirement System. Economic incentives are available to eligible employees who have less than 15 years of credited service in the Retirement System or who have at least 30 years of credited service in the Retirement System and the age for retirement or who have the age for retirement. Economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary based on employment years. Additionally, eligible employees that choose to participate in the early retirement benefit program or that choose the economic incentive and have less than 15 years of credited service in the Retirement System are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the PRDH.

The financial impact resulting for the benefits granted to participants on this program was the recognition within the PRDH's financial statements of a liability of $4,476,078 in the accompanying statement of net position as of June 30, 2019 and a charge of $836,126 under general and administrative in the accompanying statement of activities for the year ended June 30, 2019. On June 30, 2019, unpaid long-term benefits granted on this program were discounted at 2.03%.

continue

NOTE O – OTHER POSTEMPLOYMENT BENEFITS (OPEB)

In addition to the pension benefits described in Note M the Commonwealth provides other retirement benefits, such as Christmas Bonus, and healthcare benefits for its retired employees in accordance with local laws. Substantially, all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth.

Healthcare Benefits

The PRDH accounts for OPEB under the provisions of GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, that replaces GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, changes similar to those implemented on GASB No. 67, Financial Reporting for Pension Plans, and No. 68, Accounting and Financial Reporting for Pensions should be made.

This statement has substantially revised the accounting requirements previously mandated under GASB Statements No. 43 and 45. The most notable change is that the Annual Required Contribution (ARC) has been eliminated and the Net OPEB Liability will be an item on the employer's financial statement rather than a footnote entity.

GASB Number 75 governs the specifics of accounting for public OPEB plan obligation for participating employers and is required to be implemented for employer fiscal years beginning after June 15, 2017 (Fiscal Year 2017-2018). GASB No. 75 requires a liability for OPEB obligations, known as the Net OPEB Liability (Total OPEB Liability for unfunded plans), to be recognized on the balance sheets of participating employers. Changes in the Net OPEB Liability (Total OPEB Liability for unfunded plans) will be immediately recognized as OPEB Expense on the income statement or reported as deferred inflows/outflows of resources depending on the nature of the change.

As PRGERS is a multiple employer plan and the benefits are not funded by an OPEB trust, GASB No. 75 applies to the OPEB provided to each participating employer's own employees. The Central Government and its component units are considered to be one employer. Other employers also participate in PRGERS. Because certain employers that are component units of the Central Government prepare individual financial statements, a proportionate share or OPEB expense is determined for these employers.

Christmas Bonus Benefits

The Christmas Bonus was $200 per retiree pursuant to Act No. 3-2013. This benefit is recorded as expenditures when paid in the General Fund of the Commonwealth of Puerto Rico.

Healthcare Benefits

<u>Plan Description</u>

The PRDH participates in the Other Postemployment Benefit Plan of the Commonwealth of Puerto Rico (the Commonwealth) for Retired Participants of the Employees' Retirement System (the Plan). Is an unfunded, multi-employer defined benefit other postemployment healthcare benefit plan (OPEB). The Plan is administered on a pay-as-you-go basis. Accordingly, no assets are accumulated in a qualifying trust that meets the criteria in paragraph 4 of GASB Statement No. 75, Accounting and Financial Reporting for the Postemployment Benefits Other Than Pensions (GASB Statement No. 75).

continue

NOTE O – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

The Plan covers a payment of up to $100 per month to the eligible medical insurance plan selected by each member provided that the member retired prior to July 1, 2013 (Act No. 483, as amended by Act No. 3). The Plan is financed by the Commonwealth through legislative appropriations. However, the Commonwealth claims reimbursement from each employer on a monthly basis for the corresponding amount of the OPEB payments made by the Commonwealth in relation to the retirees associated with each employer. There is no contribution requirement from the plan members during active employment. The retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. Plan members were eligible for benefits upon reaching the applicable pension benefits retirement age. Act No. 3 of 2013 eliminated this healthcare benefit to the members that retired after June 30, 2013.

Relationship Between Valuation Date, Measurement Date, and Reporting Date

The Valuation Date is July 1, 2016. This is the date as of which the actuarial valuation is performed. The Measurement Date is June 30, 2017. This is the date as of which the Total OPEB Liability is determined. The Reporting Date is the employer's fiscal year date. This report is for measurement year July 1, 2016 to June 30, 2017 for reporting periods ending June 30, 2017 through June 30, 2018.

Significant Changes

There have been no significant changes between the valuation date and measurement year end. Participant Data as of July 1, 2016 was 103,345 retirees.

Deferred Inflows and Outflows

Because all participants are inactive, there are no deferred inflows and outflows of resources as changes in actuarial assumptions or demographic gains and losses are recognized immediately during the measurement year.

Total OPEB Liability

The Total OPEB Liability was determined by an actuarial valuation as of the valuation date, calculated based on the discount rate and actuarial assumptions below, and was then projected forward to the measurement date. Any significant changes during this period have been reflected as prescribed by GASB No. 75.

Total OPEB Liability	June 30, 2017	
	Total	Proportional Share (0.60325%)
Total OPEB Liability	$ 1,067,502,659	$ 6,439,762
Covered Payroll	N/A	N/A
Total OPEB Liability as a % of Covered Payroll	N/A	N/A

The PRDH's proportionate share of the Net OPEB Liability used was as follows:

Proportion - June 30, 2016	0.60346%
Proportion - June 30, 2017	0.60325%
Change - Increase (Decrease)	-0.00020%

continue

NOTE O – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

Discount Rate

The discount rate on June 30, 2016 and 2017, was as follow:

	June 30, 2016	June 30, 2017
Discount Rate	2.85%	3.58%
20-Year Tax-Exempt Municipal Bond Yield	2.85%	3.58%

As of June 30, 2019, The ERS have not issued its audited financial statements as of and for the fiscal year ended June 30, 2018 nor has it provided the PRDH with the audited schedules of employment allocations and OPEB amounts by employer as of June 30, 2019 (PRDH's measurement date), necessary to comply with the requirements of GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* as of June 30, 2019. As a result, amounts to be reported as deferred outflows\inflows of resources related to OPEB, the net OPEB liability, applicable disclosures and required supplementary information have not been actualized.

Changes in Net Pension Liability	Total Pension Liability	Proportional Share
Balance as of June 30, 2016	$ 1,374,395,292	$ 8,291,107
Changes for the year:		
Service Cost	-	-
Interest on Total Pension Liability	37,890,871	228,579
Effect of Plan Changes	-	-
Effect of Economic/Demographic (Gains) or Losses	(13,831,526)	(83,439)
Effect of Assumptions Changes or Inputs	(240,534,656)	(1,451,037)
Benefits Payments	(90,417,322)	(545,447)
Balance as of June 30, 2017	**$ 1,067,502,659**	**$ 6,439,762**

Actuarial Assumptions:

Valuation Date	July 1, 2016
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry Age Normal
Medical Trend Rate	Not Applicable

Mortality

Pre-retirement Mortality:
For general employees not covered under Act No. 127, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, they reflect mortality improvements both before and after the measurement date.
100.0% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.

Post-retirement Healthy Mortality:
Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational table, it reflects mortality improvements both before and after the measurement date.

Post-retirement Disabled Mortality:
Rates which vary by gender are assumed fordisabled retirees based on a study of plan's experience from 2007 to 2012 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. No provision was made for future mortality improvement for disabled retirees.

continue

NOTE O – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

Sensitivity of the Proportionate Share of the Total OPEB Liability to Changes in the Discount Rate

The following presents the PRDH's proportionate share of the Total OPEB Liability calculated using the discount rate, as well as what the PRDH's proportionate share of the Total OPEB Liability would be if it were calculated using a discount rate that is 1 – percentage point lower or 1 – percentage point higher than the current rate:

	1% Decrease 2.58%	Current Discount Rate 3.58%	1% Increase 4.58%
Total OPEB Liability	$ 7,085,999	$ 6,439,762	$ 5,893,401

NOTE P – AGENCY FUND

Ponce en Marcha

By Law No. 206 of August 28, 2003, the Department of Justice of the Commonwealth of Puerto Rico obtained a line of credit of $90 million with the purpose of complying with a judicial settlement in the case of the Municipality of Ponce vs. the Puerto Rico Highway Authority and others. In relation with such settlement, the PRDH is the fiscal agent of the funds for planning and development of several Municipality of Ponce projects. The restricted cash balance is $336,751 on June 30, 2019 and is presented in the *Statement of Fiduciary Net Position*.

Special Communities

The PRDH is responsible for receiving and distributing funds assigned by the Perpetual Trust Fund for Special Communities for the Development Program ("the Program"). The Program was established by Act No. 271 of November 21, 2002, and is funded through legislative appropriations and other grants. Program funds are distributed to the services providers based on the contracts made with the Perpetual Trust Fund for Special Communities. The restricted cash balance is $24,497 on June 30, 2019 and is presented in the *Statement of Fiduciary Net Position*.

Remedy Fund

The Municipality of Juncos established and funded a trust fund for the purpose of implementing the two remedies selected by the U.S. Environmental Protection Agency ("EPA") for the old Juncos Landfill Superfund site as set forth in the EPA "Decision Summary" documents dated September 24, 1991, and October 5, 1993, as amended by EPA, to correct environmental damage left by the old Juncos Landfill. As part of these remedies the PRDH was appointed as the administrator agent of the Remedy Fund. As part of the settlement agreement the PRDH established $1.5 million as Remedy Fund for construction. The restricted cash balance is $1,051,775 on June 30, 2019 and is presented in the *Statement of Fiduciary Net Position*.

NOTE Q – COMMITMENTS AND CONTINGENCIES

Interagency Agreement

On August 7, 2008, the PRDH (also referred to as the "General Partner"), the Puerto Rico Public Housing Authority (PRPHA), the Puerto Rico Housing Finance Authority ("the Authority"), and the Government Development Bank for Puerto Rico ("the GDB") entered into an Interagency Agreement ("the Agreement").

continue

NOTE Q – COMMITMENTS AND CONTINGENCIES – continuation

Pursuant to the Agreement, the PRPHA and the PRDH determined it would be advantageous for the housing projects to undergo comprehensive modernization and/or construction, which will be undertaken and operated by the Vivienda Modernization 1, LLC ("the Project Company"), whose sole member is the partnership, of which the PRDH is the General Partner (see Note F). Pursuant to the Agreement, the PRDH determined that the PRPHA is better suited to satisfy certain obligations and authorized the PRPHA to perform certain duties on behalf of the PRDH, as further detailed in Section 1(a-1) of the Agreement.

The PRDH, with agreement from the Authority and the GDB, created a fund to support the programs of the PRDH ("the Program Modernization Fund"). The Program Modernization Fund will be held jointly by the GDB and the PRDH. The PRDH will use the Program Modernization Fund from time to time to finance the costs of modernizing and/or constructing other affordable units and to provide grants to the Authority.

The Authority shall assign to the PRPHA all payments received from the Project Company in accordance with appropriate loan documents. The PRDH also assigned to the PRPHA a portion of the purchase price as reimbursement of certain costs incurred previously by the PRPHA for the rehabilitation or construction of a portion of the units.

Finally, the PRDH and the PRPHA acknowledged that some of the public housing rental developments included in the Projects were subdivided from larger projects owned by the PRPHA. The PRDH and PRPHA will permit the use of the facilities by all residents of the main and subdivided rental developments.

Ground Lease

On August 1, 2008, the PRDH entered into a ground lease agreement with Vivienda Modernization Holdings 1, S.E., and a related entity. The lease is for a period of 99 years and requires a payment of $1 per project. The related entity is required to use the land and property to rehabilitate, construct, develop and maintain public housing apartment.

Operating Leases

The PRDH has long-term operating lease agreements for substantially all of its office facilities for periods up to thirty (30) years.

Litigation – PRDH

The PRDH is a defendant in a number of lawsuits. As stated by legal counsel, the PRDH has recorded a provision of $3,280,284 in its governmental activities to cover its exposure to these lawsuits. The amount of the required reserve in other litigations that may result from the final settlement of these other lawsuits cannot be presently determined. In these cases, the ultimate amount that the PRDH may be required to pay as a result of the financial settlement of these lawsuits, if any, shall be funded through an appropriation from the Legislature of the Commonwealth of Puerto Rico.

The activity for the year related to the provision is as follows:

Beginning Balance	Increase	Decrease	Ending Balance	Due Within One (1) Year	Due After One (1) Year
$ 3,280,284	$ -	$ -	$ 3,280,284	$ -	$ 3,280,284

continue

NOTE Q – COMMITMENTS AND CONTINGENCIES – continuation

Federal and State Awards

The PRDH participates in a number of federal financial assistance programs funded by the federal government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriate grantors or their representatives. If expenditures are disallowed due to noncompliance with grant program regulations, the PRDH may be required to reimburse the grantors for such expenditures.

PRDH received two Federal Emergency Management Agency (FEMA) grant awards totaling $186.13 million to implement the New Secure Housing Program following Hurricane Georges in September 1998. In August 2012, the Puerto Rico Department of Housing submitted final expenditure claims totaling $184.34 million. FEMA requested the audit of these claims to facilitate closeout of the grants.

The U.S. Office of Inspector General (OIG) performed an examination of the New Secure Housing Program covering fiscal years ended prior to June 30, 2013. This examination identified instances of non-compliance with terms and conditions of the grant's agreements, applicable federal law, and the New Secure Housing Program's regulations, including but not limited to the expenditure of resources for ineligible purposes. OIG identified in its examination ineligible construction costs amounting to approximately $90.79 million. On April 10, 2017, the Secretary of the PRDH signed the New Secure Housing Program Voluntary Repayment Settlement Agreement (the Voluntary Settlement Agreement) with FEMA. PRDH entered into a six-year repayment plan, staring on July 31, 2017, with FEMA to return New Secure Housing funds amounting to approximately $9.8 million that were determined to be ineligible costs within the $90.79 million discussed above.

The Voluntary Settlement Agreement establishes the reimbursement to the New Secure Housing Program of the $9.8 million, from non-federal funds, for ineligible expenditures, in seventy-two monthly cash payments of $141,000, starting July 31, 2017, and continuing every month on the same date until the entire debt and all related charges are paid. (See Note K for more detail.)

The PRDH is from time to time audited by the Office of the Controller for Puerto Rico ("the Controller") which audits could result in request for reimbursements or other resolutions. These amounts, if any, of expenditures, which may be disallowed, cannot be determined at this time. Management believes that such disallowances, if any, will not have a material effect in the financial statements of the PRDH.

NOTE R – MORTGAGE INTEREST REVENUES

During the fiscal year ended June 30, 2019, the PRHD recorded mortgage interest revenues and principal payments of $516,530 in mortgage collections.

NOTE S – FUND BALANCE

The PRDH has adopted GASB Statement No. 54, which redefined how fund balances of the governmental funds are presented in the financial statements. This Statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on a government's fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

- Nonspendable – amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.
- Restricted – amounts constrained to specific purposes by their providers (such as grantors), through constitutional provisions, or by enabling legislation.

continue

NOTE S – FUND BALANCE – continuation

- Committed – amounts constrained to specific purposes by the PRDH itself, using its highest level of decision-making authority (such as legislation). To be reported as committed, amounts cannot be used for any other purpose unless the PRDH takes the same highest level action to remove or change the constraint.

- Assigned – amounts the PRDH intends to use for a specific purpose. Intent can be expressed by the PRDH or by an official or body to which the PRDH delegates the authority.

- Unassigned – all amounts not included in other spendable classifications.

Below is the detail included in the fund balance classification for the governmental funds on June 30, 2019:

General Fund

The General Fund includes the current financial resources, which relate to the general operations of the PRDH. These operations consist of the general administration and other activities not accounted for other major funds. The Nonspendable balance of $515,470 is related to prepaid and other assets and the Assigned Fund Balance of $1,626,443 on June 30, 2019 is for general administration.

Section 8 Housing Choice Vouchers Fund

The Section 8 Housing Choice Vouchers Fund has Restricted Fund Balance of $7,474,470 on June 30, 2019 related to legislative resolutions to fulfill the Agency's affordable housing programs.

FEMA Fund

The FEMA Fund has unassigned deficit of ($1,245,081) on June 30, 2019 related to pending legislative resolutions to fulfill the program funding for providing minor emergency repairs to single-family owner-occupied residences

Self-Contribution Fund

The Self-Contribution Fund has Nonexpendable Fund Balance of $28.1 million related mainly to accounts and note receivable related to the Partnership Agreement (see Note E), Committed Funds of $879,123 for general administrative expenditures not accounted for in the General Fund, and a deficiency of ($3,869,822) on unassigned funds.

Sales and Acquisition Funds

The fund has an Assigned Fund Balance of $6.6 million for the construction of houses for low income.

Other Governmental Funds

The non-major fund has a Special Revenue Restricted Fund Balance designated for specific purposes of $2.0 million related to state assignments for housing projects. Also, the PRDH has a Committed Fund Balance of $15.0 million related to legislation resolution. The remaining Assigned Fund Balance of $3.3 million, is related to a Debt Service Fund.

continue

NOTE T – GOING CONCERN – PRIMARY GOVERNMENT

The Commonwealth of Puerto Rico (Commonwealth) is in a midst of a fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, an economic recession, high unemployment rate, a population decline, and high levels of debt and pension related obligations. As the Commonwealth's tax base shrunk and its revenues were affected by the prevailing economic conditions, an increasing portion of the Commonwealth's General Fund budget was allocated to health care and pension related costs, debt service requirements through fiscal year 2017, and funding for essential services has been reduced. The Commonwealth's liquidity constraints, among other factors, affected its credit ratings and its ability to obtain financing at prevailing interest rates.

In response to the Commonwealth's current fiscal crisis, the United States Congress enacted PROMESA establishing the Oversight Board. On May 1, 2017, the temporary stay under Title IV of PROMESA expire, permitting substantial litigation brought by bondholders and other creditors against the Commonwealth and its component units to resume and new suits to be initiated. As a result, on May 3, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for the Commonwealth by filling a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico (the Title III Court). Title III of PROMESA incorporates the automatic stay provisions of Bankruptcy Code Sections 362 and 922, which are made applicable to Title III cases pursuant to PROMESA Section 301(a). Accordingly, upon the filling of the Commonwealth's Title III case, an automatic stay immediately went into effect to stay creditor litigation.

Since June 30, 2014, the principal rating agencies lowered their rating on the general obligation bonds of the Commonwealth, which had already been placed in a default rating of "D". they also lowered similarly to a default grade their ratings on the bonds of the PBA and GDB, while the ratings on the bonds of COFINA have been lowered multiple notches to a current noninvestment grade level of Ca, CC and D (depending on the particular rating agency), although certain COFINA bonds have been placed on positive outlook as the result of developments in the Title III cases.

The following activities, funds, and blended component units reflect a net position deficit/fund balance deficit as of June 30, 2017 (expressed in thousands), last audited financial statements:

	Deficit Balance
Primary Government:	
Governmental Activities	$71,129,600
Component Units	12,085,936
General Fund	100,564
Debt Service Fund	866,852
Other Nonmajor Fund	39,070

The Commonwealth's Governmental Activities show a net position deficit of approximately $71.1 billion as of June 30, 2017. The Commonwealth's General Fund shows a fund balance deficit of approximately $100.6 million.

The fund balance deficit is attributable to operating expenses exceeding revenues. The risks and uncertainties facing the Commonwealth, together with other factors, have led management to conclude that there is substantial doubt as to the ability of the Commonwealth to continue as a going concern.

Another aspect of the Commonwealth's operations contributing to the aforementioned deficits and liquidity constraints relates to the Commonwealth's education costs, representing a very high percentage of its budgetary expenditures, and the Commonwealth's challenges in controlling such costs. The budget appropriation for the Commonwealth's Department of Education has historically represented a significant portion of the total General Fund budget.

continue

NOTE T – GOING CONCERN – PRIMARY GOVERNMENT – continuation

The Commonwealth's ability to reduce its General Fund deficit and to achieve a balanced budget in future fiscal years depends on a number of factors, some of which are not wholly within its control, including the performance of the Commonwealth's economy, that actual collections of taxes meet the Treasury Department's projections, and the government's ability to reduce and control governmental expenditures, particularly in areas such as education, public safety and healthcare, which represents a significant portion of the budget appropriations of the Commonwealth. The Commonwealth will not be able to honor all of its obligations as they come due while at the same time providing essential government services. These factors create an uncertainty about the Primary Government's ability to continue as a going concern.

As part of the original Fiscal Plan approved by the Oversight Board on March 13, 2017 presented by the Governor of Puerto Rico to attend the fiscal crisis, contemplates a reduction of $350.0 million of subsidies to the municipalities of Puerto Rico. Already in FY 2018, the total municipal appropriation was reduced by $150 million, bringing the new baseline appropriations to $220 million per year. Going forward from this baseline, with the New Fiscal Plan approved by the Oversight Board on April 19, 2018, there must be a reduction of 20% in each successive year, holding appropriations constant at 80% of current levels starting in FY 2022 before ultimately phasing out all subsidies in FY 2024. A new Fiscal Plan was approved by the Oversight Board on May 9, 2019 (see Note 26 for more details).

PUERTO RICO FILES FOR BANKRUPTCY UNDER PROMESA TITLE III

On May 3, 2017, the Commonwealth of Puerto Rico and the Oversight Board established by Congress filed for bankruptcy under Title III of PROMESA in what is poised to become one of the largest bankruptcies in the United Stated history.

Both the Oversight Board and the New Commonwealth Administration have expressed a strong preference for restructuring the Commonwealth' debt through the use of Title VI. However, when the it comes to the debt of the Commonwealth and those instrumentalities that rely on its taxing power for debt service, as opposed to the debt of certain of its instrumentalities, Title VI is unlikely to provide a realistic path to restructure such debt for the following reasons:

- Unlike Title III, Title VI contains no automatic stay of creditor litigation upon the commencement and during the continuation of the restructuring process. As the current stay is set to expire in May 2017, with limited options available for a further extension.

- Any attempt to restructure the Commonwealth debt through Title VI will likely be complicated when existing litigation resumes, and additional litigation is commenced.

- Although that is a critical dispute.

- In addition, creditors already have challenged the invocation of the clawback by the Commonwealth, asserted claims against the Commonwealth based on violations of statutory impairment provisions, alleged that various property interest have been taken in violation of constitutional protections, and claimed violations of PROMESA and other statutes, and

- Regardless of the validity of these claims, it is clear that they will not all be resolved in the likely time frame that a Title VI process will take, and the outcome of such litigation, as well as other litigation that surely will be commenced upon the expiration of the current stay, could alter or harden the positions of the affected parties and change their willingness to compromise their claims.

continue

NOTE T – GOING CONCERN – PRIMARY GOVERNMENT – continuation

Remediation Plan

On March 13, 2017, the Oversight Board certified its own new Fiscal Plan for the Commonwealth. The Fiscal Plan has been subject to various revisions. On May 27, 2020, the Oversight Board certified its most recent Fiscal Plan for the Commonwealth, which included the following categories of structural reforms and fiscal measures:

(i) *Human Capital & Welfare Reform*
(ii) *Ease of Doing Business Reform*
(iii) *Energy and Power Regulatory Reform*
(iv) *Infrastructure and Capital Investment Reform*
(v) *Establishment of the Office of the CFO*
(vi) *Agency Efficiencies Measures*
(vii) *Healthcare Reform*
(viii) *Tax Compliance and Fees Enhancement*
(ix) *Reduction in UPR and Municipality Appropriations*
(x) *Pension Reform*
(xi) *Fiscal Controls and Transparency*

There is no certainty that the Oversight Board Fiscal Plan (as currently certified or as subsequently amended and recertified) will be fully implemented, or if implemented will ultimately provide the intended results. All these plans and measures, and the Commonwealth's ability to reduce its deficit and to achieve a balanced budget in future years depends on a number of factors and risks, some of which are not wholly within its control.

On September 27, 2019, the Oversight Board filed a proposed plan of adjustment of Commonwealth debt that would reduce most of the Commonwealth's debt obligations by approximately 70% and establishes a roadmap to exit bankruptcy. As of the date of these basic financial statements, the disclosure statement accompanying the proposed plan of adjustment has not yet been approved by the Title III Court and no solicitation of the proposed plan has been approved. It is uncertain that eligible creditors will vote in favor of or if the Title Court will ultimately confirm the Oversight Board proposed plan of adjustment.

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA)

The Puerto Rico Oversight, Management, and Economic Stability Act, Pub. Law 114-187 ("PROMESA" or the "Act"), was enacted into law on June 30, 2016. The Senate had passed PROMESA on June 29, 2016, and President Obama signed the Act into law on June 30, 2016, one day before the Commonwealth of Puerto Rico was expected to, and did, default on substantial payment obligations.

PROMESA Overview

Background

Prior to the enactment of PROMESA, Puerto Rico had been mired in an economic and demographic downward spiral for a decade. As of 2018, the economy was $18 billion smaller in real terms and the population was more than half a million smaller (largely due to outmigration) than it was in 2005 – trends that, even before recent natural disasters, were projected to continue. Over 40% of the population (including ~58% of Puerto Rican children) lives below the poverty line, and ~47% are dependent on Medicaid for healthcare.

Meanwhile, before PROMESA, the consolidated Commonwealth's outstanding debt and pension liabilities had grown to over $120 billion – with more than $70 billion in financial debt and more than $50 billion in pension liabilities – an amount almost twice the size of Puerto Rico's economy.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Also, before PROMESA was enacted, Puerto Rico had passed the Puerto Rico Corporation Debt Enforcement and Recovery Act (the "PR Recovery Act") in 2014. The PR Recovery Act would have enabled certain of Puerto Rico's instrumentalities to adopt a recovery or restructuring plan for their debt. However, in *Puerto Rico v. Franklin Cal. Tax-Free Trust, et al.*, 136 S. Ct. 1938 (2016), the United States Supreme Court held that the PR Recovery Act was invalid because it was preempted by the United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq., as amended (the "Bankruptcy Code"). In sum, the Supreme Court found that the Bankruptcy Code applies to Puerto Rico by including the territory within the definition of a "State" (except in the case of Puerto Rico for purposes of determining whether a State's municipalities may be debtors thereunder). The Court then concluded that the PR Recovery Act was preempted by a provision of the Bankruptcy Code prohibiting States from enacting their own bankruptcy legislation.

PROMESA

Unlike the PR Recovery Act, PROMESA is a federal legislative enactment. The Act is very extensive and the first of its kind in many respects. PROMESA includes a variety of provisions applicable to Puerto Rico, its instrumentalities and their liabilities and operations. The following is a summary of PROMESA, which is intended as a broad overview of primary provisions of PROMESA.

Oversight Board: The Act establishes a seven-member Oversight Board, the members of which will be designated by Congress and the President. The Oversight Board is provided with broad authority over Puerto Rico and instrumentalities of Puerto Rico which the Oversight Board designates as "covered" instrumentalities.

The Oversight Board is generally an autonomous body that has broad authority and discretion over Puerto Rico, including the ability to place Puerto Rico itself and a "covered" instrumentality into a debt restructuring proceeding established under the Act, require and approve a fiscal plan, require and approve a budget, oversee operations and implement changes that are necessary to comply with an approved fiscal plan or budget, approve the issuance of debt, hold hearings and issue subpoenas in furtherance of its functions, enter into its own contracts, analyze a territory's pensions and pension liability, approve voluntary settlements with creditors, and become a direct party in litigation against Puerto Rico or an instrumentality. The Oversight Board is, in effect, considered a division of the territory and can hire officers, professionals and legal counsel.

The definition of "territorial instrumentality" in PROMESA provides that such definition includes an “instrumentality of a territory". In addition, by analogy, the definition of "municipality" in the Bankruptcy Code is similarly defined as an instrumentality "of a State". However, courts have held, and commentators have noted, that a municipality under the Bankruptcy Code includes not only an instrumentality of a State, but also an instrumentality of an instrumentality of a State.

FISCAL PLAN TARGETS AND GUIDELINES

At its November 18, 2016 public meeting here in Puerto Rico, the Oversight Board adopted and communicated publicly a set of five principles to evaluate the Government of Puerto Rico’s proposed fiscal plan and to assess the degree to which the plan meets the 14 criteria established by PROMESA. This set of five principles adopted by the Oversight Board and the 14 criteria established by PROMESA regarding the elaboration of the fiscal plan are as follows:

Principles:

Principle 1: The long-term fiscal plan must cover at least the next 10 fiscal years with meaningful progress in the next five and meet the standards set forth in the law (the 14 criteria). The fiscal plan should aim to meet the statutory criteria for the Board to be terminated within 10 years, which includes having adequate market access at reasonable rates and having at least four consecutive years of balanced budgets in accordance with modified accrual accounting standards.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Principle 2: The fiscal plan must work to stabilize the current economic situation, increase the economy's resilience, shore up public finances, support long-term, durable growth, meet basic needs of the citizenry, and restore opportunity for the people of Puerto Rico.

Principle 3: To properly establish an accurate assessment of the fiscal outlook, the base-case scenario within the fiscal plan must assume no additional federal support beyond that which is already established by law (e.g., no Affordable Care Act support extension) and no reliance on unsustainable Act 154 revenues in light of the expiration of said act. Initiatives included in the fiscal plan must be based on applicable laws or specific bills that require enactment in order to reasonably achieve the projections of the fiscal plan.

Principle 4: The plan must include an appropriate mix of structural reform, fiscal adjustment, and debt restructuring. It must be informed by the relevant analytical tools (e.g., a debt sustainability analysis and a detailed economic projection) that assure the Board that the GPR is pursuing a comprehensive approach to address acute economic, budgetary, and demographic challenges.

Principle 5: The fiscal plan must be accompanied by relevant operational plans that show how the GPR will achieve the changes and reforms it proposes

CRITERIA FOR FISCAL PLANS

Section 201(b) of PROMESA identifies 14 specific components and objectives a fiscal plan should address. In particular, PROMESA stipulates that the fiscal plan must provide a method to achieve fiscal responsibility and access to the capital markets, in addition to the following:

1. Provide for estimates of revenues and expenditures in conformance with agreed accounting standards and be based on (i) applicable laws; or (ii) specific bills that require enactment in order to reasonably achieve the projections of the fiscal plan;
2. Ensure the funding of essential public services;
3. Provide adequate funding for public pension systems;
4. Provide for the elimination of structural deficits;
5. For fiscal years in which a stay is not effective, provide for a debt burden that is sustainable;
6. Improve fiscal governance, accountability, and internal controls;
7. Enable the achievement of fiscal targets;
8. Create independent forecasts of revenue for the period covered by the fiscal plan;
9. Include a debt sustainability analysis;
10. Provide for capital expenditures and investments necessary to promote economic growth;
11. Adopt appropriate recommendations submitted by the Oversight Board;
12. Include such additional information as the Oversight Board deems necessary;

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

13. Ensure that assets, funds, or resources of a territorial instrumentality are not loaned to, transferred to, or otherwise used for the benefit of a covered territory or another covered territorial instrumentality of a covered territory, unless permitted; and

14. Respect the relative lawful priorities or lawful liens in the constitution, other laws, or agreements of a covered territory or covered territorial instrumentality in effect prior to the enactment of PROMESA.

In light of the debt crisis and unsustainable path of the Government's finances, when the Oversight Board was appointed in 2016, it set out to find long-term solutions, certifying Fiscal Plans that have established the following priorities:

- **Creating a leaner, more affordable government.** The Oversight Board has outlined necessary operational changes to streamline the Government and enable the reduction of unnecessary administrative expenses. Such reforms include improving management of the public education system, pursuing civilianization to enable more sworn police officers to move into the field, consolidating agencies to enable coordination and back-office efficiencies, reducing the correctional system footprint to enhance staffing practices, privatizing WIPR, incorporating best practices in digitization, and improving Elections Commission operations. As such, the Oversight Board has identified how to remove barriers to efficient and effective government service delivery.

- **Identifying specific actions needed to reform the structure of the economy and create the conditions for growth in Puerto Rico.** The Oversight Board has provided a comprehensive plan for as well as targeted investments to drive economic growth by improving participation in the formal labor market; spurring job creation; transforming the education system; improving access to reliable infrastructure and energy; and supporting the people of Puerto Rico through workforce development programs.

- **Increasing transparency of and controls over Government finances.** By instituting budgets designed at the cost concept level, regular reporting on cash and actual expenditures, formal processes for reapportionments and allocation of capital expenditures, and reviews of major contracts to ensure fiscal plan compliance, the Oversight Board has given stakeholders a common fact base around the Government's fiscal situation and reduced superfluous and non-transparent spending.

- **Directing resources to front line service delivery.** The Oversight Board has enhanced the impact of Government spending through priority investments in areas of demonstrated need such as public safety, health care, and education, and to enable response to natural disasters.

- **Maximizing the impact of federal investments in Puerto Rico.** The Oversight Board has placed particular emphasis on aligning federal funds towards investments that will accelerate progress as much as possible against the key reform areas, such as infrastructure, COVID-19 response, health system improvements, educational outcomes, and economic growth.

***Fiscal Plans and Budgets*:** A critical component of PROMESA is the requirement of Puerto Rico and covered instrumentalities to develop and maintain a fiscal plan. A fiscal plan for the territory, or any instrumentality designated by the Oversight Board, generally must contain numerous provisions governing the operation of the territory or instrumentality including plans to pay debts, eliminate deficits, maintain essential public services and impose internal controls for fiscal governance and accountability. Each fiscal plan is also required to set forth methods for the territory or instrumentality to access the capital markets.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

The fiscal plan must be developed by the governor, with oversight by the Oversight Board, and submitted to the Oversight Board for approval (the Oversight Board can submit its own fiscal plan if the governor's fiscal plan is not acceptable in the sole discretion of the Oversight Board). A fiscal plan is also required to comply with Puerto Rico law and to maintain valid liens.

The Act further specifies that no budget can be submitted by the territory's governor to its legislature unless the Oversight Board has approved a fiscal plan and the budget is consistent with the fiscal plan (and, similar to fiscal plans, the Oversight Board can submit its own budget if the governor's budget is not acceptable in the sole discretion of the Oversight Board). Annually, the Commonwealth submitted the Fiscal Plan, but the Oversight Board certifies his own Fiscal Plan.

Fiscal Plan – 2019

On January 18, 2019, the Oversight Board requested the Governor to submit Fiscal Plan to the Commonwealth to replace the October Fiscal Plan. The New Fiscal Plan of the Oversight Board, instead of the Commonwealth, was approved on May 9, 2019.

Just as the Island was recovering from political disruption and embarking on reconstruction at the end of 2019, Puerto Rico suffered the most serious earthquakes in recent memory, resulting in structural damage to buildings across southwestern Puerto Rico. Residents of these communities were subjected to hundreds of aftershocks over several months, some approaching the strength of the first earthquakes. Communities faced concerns over public safety as infrastructure was affected, businesses suffered further disruption, and the Government saw damage to schools, prisons and other crucial infrastructure. The full extent of the damage is still unknown, and rebuilding efforts in some places have not yet begun.

Finally, only two months later, Puerto Rico – along with the rest of the world – was confronted with the COVID-19 global pandemic. Overnight, the economy shut down except for the most critical activities as the Government took prudent steps to mitigate the risk of a catastrophic public health crisis. Unemployment has skyrocketed as many businesses have been forced to shut down, and the local and federal governments have quickly mobilized to provide support. Many projections indicate that the economic shock due to COVID-19 will be worse than that of the Great Recession. The pathway to economic recovery remains highly dependent on the overall public health response and the federal government's ability to provide economic support for those whose livelihoods are at risk.

Fiscal Plans have pressed for major structural reforms to restore competitiveness, enable growth, and spur a return to prosperity. These include human capital, welfare, and education reforms to advance successful participation in the formal labor market, reforms to streamline core business processes (e.g., paying taxes, registering property and obtaining permits) to improve the ease of doing business and enable job creation, and proposals to enable reliable power and stable infrastructure for businesses and households. In addition to these structural reforms, the Fiscal Plans have focused on improving the responsiveness and efficiency of the Government, while reducing unnecessary administrative expenses and mitigating the escalating growth of healthcare and pension costs, which could otherwise cripple future governments.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

The Fiscal Plans have accompanied these reforms with targeted investments in and support for those on the front lines of service delivery. Over the years, the Fiscal Plans have provided for salary raises for teachers, principals, firefighters, and police officers to ensure salaries for these critical frontline roles are more competitive. Strategic capital investments have been made in hospitals, correctional institutions, public safety equipment, and other infrastructure. Moreover, the Fiscal Plans have included increased spending in areas that are important for the people of Puerto Rico: funds for an Earned Income Tax Credit to encourage more formal labor market participation, needs-based scholarships for UPR to ensure every student on the Island can access higher education, funds for the Puerto Rico Clean Water and Drinking Water State Revolving Fund, and an emergency reserve to enable immediate Government action in times of crisis, among others.

At the onset of the COVID-19 crisis, the Oversight Board mobilized in close partnership with the Government to deliver immediate support and relief. This included providing a $787 million package of measures to support front-line workers and small businesses. The Government also took executive actions that the Oversight Board supported to provide temporary relief on tax payment deadlines. Finally, the Oversight Board approved actions to provide a $400 million advance on federal funding for economic impact payments administered by Hacienda, as well as a liquidity facility of up to $185 million for municipalities suffering from revenue collection deferrals.

Since certifying the first Fiscal Plan in 2017, and notwithstanding the emergencies, the Oversight Board has been able to drive meaningful progress in creating a leaner, more affordable government. This has resulted in the ability of the Government to increase expenditures at a time of crisis, while ensuring total expenditure levels remain within total available revenues, rather than be forced to cut budgets that have not been carefully managed, as other states have been forced to do as COVID-19 has caused revenues to drop. There is a new level of transparency and control over Government spend, including the elimination of multi-year appropriations that permitted overspending; controls over the reapportionment of funding between concepts of spend to eliminate the defunding of accrued liabilities; and regular reporting on revenues and expenses.

Moreover, the 2020 and 2021 budgets were built at a granular “concept code” level (e.g., differentiating between spend on professional IT services versus advisory services). The Oversight Board has been able to reject contracts that could have led to overspending, such as the proposal to externalize Puerto Rican prisons, and the Government has been held accountable to its implementation requirements via public hearings, such as those held on education, public safety, corrections, and economic development.

Fiscal Plan – 2020

The 2020 Fiscal Plan financial forecasts suggest that the current financial trajectory is not sustainable in the long-term. Perhaps more importantly, the 2020 Fiscal Plan – even if implemented in full – will not raise Puerto Rico and its residents to a level of prosperity comparable to even the poorest states on the US mainland. There continues to be insufficient political appetite to drive the types of structural reforms that are needed to create sustainable economic growth and an inability to implement even reforms that have nominally been agreed-upon.

As the US and Puerto Rico begin to recover from the current economic and health crisis, and while there is national fiscal and monetary policy support, the Government must act with an exceptional level of determination. With so many residents suffering from the economic consequences of successive natural disasters, the need for change is even more urgent.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

The 2020 Fiscal Plan includes dozens of practical actions that the Government must take to create a more accountable, affordable, and transparent government, with resources focused on improving the front-line services that matter. Given the global COVID-19 pandemic, the 2020 Fiscal Plan pauses most government right-sizing measures for a year, so that the full focus of Government may focus on recovery and implementation. To drive efficient and successful implementation of key reforms and outcomes, the 2020 Fiscal Plan also introduces milestone budgeting, which will provide for investments in certain areas once key milestones are achieved. Crucial milestones include: final establishment of the Defined Contribution accounts for public retirees and employees; the publication of the 2017 Comprehensive Audited Financial Report (and progress towards publication of subsequent year reports); implementation of time and attendance reporting; and meaningful consolidation of back-offices to create efficiencies, among others.

The 2020 Fiscal Plan also lays out discrete actions that must be taken to make structural reforms to the economy, improving labor force participation, the ease of doing business, and energy and infrastructure management. Finally, the 2020 Fiscal Plan includes strategic one-time investments to speed up Puerto Rico's recovery in light of the natural disasters and COVID-19 by allocating funds to strengthen the Island's public healthcare system, human capital, and telecommunications infrastructure.

Absent real reform, Puerto Rico may not ever fully recover from all its recent crises. The 2020 Fiscal Plan lays out the meaningful changes needed to lead to an effective, responsive government and growing economy.

Restoring Growth to the Island

The fiscal and economic turnaround of Puerto Rico cannot be accomplished without the implementation of structural economic reforms that promote the transformation of the Island's economy and its workforce. Puerto Rico struggles from an uncompetitive labor market, unreliable energy and infrastructure, regulatory and other burdens that hinder business productivity, and low educational outcomes and workforce support – all of which prevent it from competing in a global economy and from attaining positive economic growth. Structural reforms—those that seek to strengthen the fundamental drivers of economic growth to encourage job creation, investment, and increased productivity—could transform Puerto Rico's future.

Years of successive natural disasters and health crises further underscore the need for comprehensive Government action as outlined in this 2020 Fiscal Plan to reverse the economic challenges that have plagued the Island and its people for far too long. If implemented quickly and widely, structural reforms are projected to drive real economic growth, reversing decades-long economic challenges and enabling the Island's economy and its people to flourish.

Specifically, the Government must pursue the following structural economic reforms to achieve their forecasted economic impact:

Human Capital & Welfare Reform (Chapter 8)

As of 2019, Puerto Rico's formal labor force participation rate stood at 39%, the second-lowest in the world and far below US and Caribbean averages. The youth unemployment rate is equally high—24.7%—roughly double the world average (12.7%) and three times the US average (8.4%). Bringing labor force participation rate in line with that of even the lowest US state (West Virginia, with 54%) would improve employers' flexibility and create labor conditions closer to those on the mainland, driving economic growth and reducing poverty.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Puerto Rico's low labor force participation is primarily a function of public policy, namely, suboptimal welfare requirements and underperforming human capital development systems. The Island's low labor force participation predates the 2017 hurricanes, the 2019-20 earthquakes, the COVID-19 pandemic, and even the economic downturn that began in 2006. According to the World Bank, Puerto Rico's labor force participation rate has ranked in the bottom-20 of more than 200 global economies since at least 1990.

Suboptimal welfare requirements: Current welfare eligibility programs may disincentivize some residents from pursuing work within the formal economy in order to ensure sufficient nutritional support, housing and healthcare. For instance, current welfare eligibility guidelines phase-out sharply as beneficiaries' income rise, informally taxing workers for seeking work within the formal economy. This phenomenon is particularly pronounced in the case of recipients of public housing assistance: even securing a *part-time* minimum wage job can render a beneficiary ineligible for public housing, potentially forcing some beneficiaries to choose between formal sector work and keeping their homes. Revised eligibility guidelines and other policies that encourage residents to work could help resolve these issues.

Underperforming human capital development systems: 20% of working-age Puerto Ricans lack a high school diploma, nearly double the US average (12%), and only 45% of K-12 students have reached Spanish proficiency on META-PR exams (the Island's standardized tests). Worker training programs, meanwhile, are rare and disjointedly managed by 15 local workforce boards. Strengthening the Island's education system and introducing coordinated workforce development programs could mitigate these challenges and help ensure that all Puerto Ricans are able to participate in the current and future economy.

Unfortunately, the Government has delayed the implementation of many human capital and welfare reforms intended to address these structural challenges, reducing the potential economic uplift to the Island and delaying the opportunity for residents in need of this critical support. Continued Government inaction will further jeopardize the development of Puerto Rico's human capital, the opportunities available to each resident of Puerto Rico for personal development and economic self-sufficiency, projected GNP uptick and its associated increases in tax revenues.

To realize the associated increases to GNP, the Government must begin implementing the following human capital and welfare reforms beginning in FY2021.

- **Broadly-publicize the new Earned Income Tax Credit (EITC) by:**
  - ⇨ Hacienda: Transferring EITC promotional responsibilities to ADSEF
  - ⇨ ADSEF: Designing a multifaceted EITC outreach strategy (including working with community organizations throughout the Island)
- **Introduce a Nutritional Assistance Program (NAP) Work/Volunteer Requirement by:**
  - ⇨ ADSEF: Creating a work/volunteer requirement compliant with Certified Fiscal Plan parameters
  - ⇨ ADSEF: Completing all administrative requirements (e.g. obtaining Federal Government approval) necessary to implement a work/volunteer requirement
  - ⇨ ADSEF: Verifying the eligibility of all adult NAP recipients for the new work/volunteer requirement
- **Create High-Quality Workforce Development Programs by:**
  - ⇨ DDEC: Creating partnerships with private and social sector organizations to strengthen worker training
  - ⇨ DDEC: Conducting regular analyses to understand private sector labor market needs
  - ⇨ DDEC & Vivienda: Allocating resources in a data-driven manner
  - ⇨ DDEC: Removing structural barriers to employment (e.g. difficult in securing transportation and childcare to go to work)

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

K-12 Education Reform (Chapter 9)

A high-quality education is the linchpin for social mobility for the residents of Puerto Rico—especially after years of devastating natural disasters and the COVID-19 crisis. Comprehensive K-12 education reforms will empower every Puerto Rican to develop the skillsets needed to achieve economic self-sufficiency and join the formal workforce. Together with *Section 13.3*, which outlines the necessary management improvements and operational efficiencies that the Department of Education (PRDE) must pursue, this chapter provides a transformation roadmap that will truly change K-12 student outcomes on the Island, and therefore enable greater workforce participation and productivity.

Studies show that mainland workers that attain fluency in both English and Spanish earn $2,800 more per year than their monolingual peers, and that a one-quarter standard deviation in school quality across US states would produce an average 0.35% long-run growth rate uptick. In addition, Puerto Rican workers (ages 65 or below) with a high school diploma earn three times as much as residents who lack one. Indeed, improvements in education will bring prosperity and growth to individuals and the Island as a whole.

Meanwhile, more than 290,000 children rely on PRDE to serve as their primary vehicle for social mobility. Three years have passed since the certification of the first Fiscal Plan for Puerto Rico, yet PRDE continues to delay the comprehensive reforms necessary to meet the developmental needs of all children and prepare every student for success in higher education or the workforce. PRDE has allowed school underperformance to persist, with just 45% of students proficient in Spanish, 39% in English, and 30% in mathematics in 2019, and with particularly sharp drops in English between third and fourth grade and in mathematics and Spanish proficiency between fifth and sixth grade. PRDE has left 33% of third graders at-risk of not graduating high school and delayed the introduction of evidence-based practices that are important to properly serve Special Education students (who comprise a greater share of the student population—32%— than in any other US jurisdiction).

Although natural disasters and the COVID-19 pandemic have wrought substantial destruction, relief funds in response to these events offer PRDE an unprecedented opportunity to reshape Puerto Rico's public schools for the better. In the aftermath of the 2017 hurricanes, PRDE was awarded $589 million in Immediate Aid to Restart School Operations (RESTART) funds to offset expenses associated with reopening schools. As discussed in *Section 13.3*, PRDE will now receive over $349 million under the CARES Act as well. Finally, the Oversight Board allocated $124 million in additional Commonwealth funds to purchase tablets, software, and training services necessary to support distance learning for all PRDE students and teachers as part of the Emergency Measures Support Package in response to the COVID-19 emergency.

Investing in Student Outcomes

The Oversight Board believes deeply in the importance of a high-quality public-school system for the children of Puerto Rico. While improving the quality of schools and student outcomes will take real transformation on the part of the Department of Education, the Fiscal Plan includes funds to cover particular programs that will enable the Department to improve student outcomes. These investments are outlined below.

- **Distance Learning (~$254 million):** The Fiscal Plan includes emergency funding to enable the purchase of tablets, software, and training services necessary to support distance learning for all PRDE students and teachers as part of the Emergency Measures Support Package issued in response to the COVID-19 emergency. The Fiscal Plan expects PRDE to use these funds to provide online education offerings as quickly as possible

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- **English Language Learning Teacher Development Program (~$1.5 million):** Beginning with the 2020-2021 school year, the Department of Education will partner with a national non-profit organization to identify, recruit, and train ELL teachers across Puerto Rico, at the recommendation of the Oversight Board. The Oversight Board suggested this partnership recognizing the important impact that bilingual education has on students, driving lower child and adult poverty while also expanding professional opportunities. In order to fund this project, PRDE and the non-profit organization will apply for a competitive federal grant. This grant will potentially cover the costs associated with the non-profit organization for the initial three years, after which the training program will be fully implemented and PRDE will have built the internal capacity and resources to scale the program over the long term. During the first three years alone, the program will train approximately 300 English teachers, with an expected impact on nearly 90,000 students.

- **Dedicated School Psychologist Program (~$50 million per year):** The 2020 Fiscal Plan provides the budget to fund the hiring of one in-house psychologist per PRDE school to help the Department better meet the social-emotional and developmental needs of all students, beginning with the 2020-2021 school year. Specifically, the Oversight Board will allocate $52 million to hire 856 school psychologists that will join the Department as full-time employees. Their objectives are two-fold: on the one hand, school psychologists will provide early interventions (e.g. behavioral screenings) to connect students with appropriate resources and ensure that children are not erroneously classified as Special Education students. Additionally, school psychologists will ensure that Special Education students receive adequate academic and behavioral support as required by their IEP—reducing the number of students who enter "Remedio Provisional"**.**

- **Innovation in Education (~$7 million):** To encourage schools to explore new ways of learning, the Fiscal Plan includes a potential $100,000 reward for 10 schools per region to implement an education innovation project during the second semester.

- **Incentives to Improve School Performance and Reporting (~$2 million):** Making real progress on reform in the Department of Education will start with being able to monitor, measure, and report data better. The Fiscal Plan thus includes $2 million in funds as an incentive (potential $1,500 one-time bonus) for school directors that perform well on scorecards based on data captured and approved methodology to measure outcomes.

To afford all Puerto Ricans an equal opportunity to develop the knowledge and skillsets needed to contribute to the Puerto Rican economy, PRDE must begin implementing education reforms in FY2021. As described in its State Plan, PRDE aims to achieve 73% student proficiency in mathematics, 77% proficiency in English, and 80% proficiency in Spanish across all grade levels by the 2021-22 school year. These targets are extremely ambitious given current student performance—in mathematics alone, reaching this target would require doubling the average student proficiency in only a matter of years (currently 30%). Nonetheless, the future of Puerto Rico relies on PRDE delivering this level of improvement. To achieve these targets—and ensure that PRDE makes a concerted effort to offer the children of Puerto Rico the high-quality education that they deserve—comprehensive reforms must begin immediately, particularly in areas such as English Language Learning (ELL), K-5 literacy, and STEM instruction.

To maximize the likelihood of success, education reforms should build on the improvement areas PRDE identified in 2017: increased student achievement (as measured by META-PR scores and graduation rates), stronger professional development for directors and teachers, and more efforts to support the developmental needs of the whole child. As such, the Government's overhaul must:

- Define goals and design PRDE's 2022-27 strategic plan to guide reforms
- Launch evidence-based curriculum reforms
- Create a post-COVID-19 back-to-school plan and stand up distance learning capabilities
- Improve professional development opportunities for directors and teachers

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- Make targeted investments to boost family engagement
- Systematically collect, manage, and leverage data for better decision-making

These reforms must collectively aim to strengthen system-wide accountability among educators and administrators; facilitate data-driven leadership at the central, regional, and school level; and increase PRDE's responsiveness to the needs of the whole child and the broader community on the Island. Moreover, the Oversight Board welcomes PRDE, its non-Government partners, and other Government agencies to design and propose further innovative reforms to strengthen PRDE schools.

Ease of Doing Business Reform (Chapter 10)

In 2020, *Doing Business*—an independent assessment of the ease of doing business in 190 economies—rated Puerto Rico the 65th most business-friendly economy. The Island's ranking trails the mainland's (ranked 6th in 2020) and has worsened since 2006, when Puerto Rico was ranked 18th. Bringing the Island's business environment in line with Mexico—the top-ranked Latin American and Caribbean economy (49th)—will give Puerto Rico the edge that it needs to play in an increasingly competitive environment. The Island competes regionally for investments like tourism; internationally for pharmaceutical, knowledge services, hospitality and tourism investments; and, overall, with mainland states. The Island must improve its business-friendliness and consider ease of doing business reforms to support economic growth.

Instituting comprehensive reforms is particularly important in light of the COVID-19 pandemic. As economic activity slows, companies look to shift supply chains back to the US, and other economies implement rapid reforms to capture growth, instituting ease of doing business reforms is critical. In the aftermath of the pandemic, many firms—especially small businesses—will continue to face significant headwinds (e.g. falling demand for their goods and services), underscoring the need to generate economic activity and attract new investments across the Island. And, while delaying reforms will undermine Puerto Rico's ability to recover from the pandemic, failure to institute them at all will enable mainland states and rapidly-reforming countries to out-compete Puerto Rico for key investments, such as pharmaceutical manufacturing facilities. For example, Costa Rica, a major competitor for knowledge services investments, improved from 121st in the 2010 *Doing Business* survey to 74th in the 2020 iteration, and has become a top player in the field.

Ease of doing business remains an area in which Puerto Rico has much room for improvement. The 2019 Fiscal Plan re-iterates the **need for urgent action, particularly in light of no progress in Puerto Rico's ranking in the categories of Ease of Doing Business that have proven most important to stimulating growth in other jurisdictions.** For example, from 2018 to 2019, Puerto Rico fell 3 slots in construction permitting, from 138 to 141, in registering property, 6 slots from 153 to 159, and in starting a business 6 slots from 47 to 53.

The Oversight Board acknowledges recent initiatives announced by the Government to streamline the permitting process and expects committed actions to ensure that this results in meaningful change during the next fiscal year.

In the 2018 and 2019 Ease of Doing Business Report, Puerto Rico was ranked 64th. This represents a 9-point decline from 2017 and is 58 spots lower than the U.S., which ranks 6th overall. While the overall ranking did not change in 2019, the underlying trends on the most critical improvements needed to encourage growth in Puerto Rico were negative – such as getting electricity, construction permitting, and registering property. There are some areas of strength: Puerto Rico placed 6th for Getting Credit and 9th for Resolving Insolvencies. It has also made recent efforts to digitize government services to improve speed and accessibility, having launched the Single Business Portal (SBP) in July 2018, which currently includes online filing system for defined Acts (Acts No. 14, 20 and 22) but should ultimately consolidate permit requests, filing for incentives and annual reporting on these Acts.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Puerto Rico should achieve a best-in-class business environment by taking targeted steps to improve rankings in key identified Doing Business Index indicators by FY2023, with the goal of closing the gap with the mainland U.S. by at least 50% from its 2018 rankings:

Puerto Rico's relatively low-ranked business-friendliness is attributable to deficiencies in Government regulations or processes (see *Exhibit 59*), including:

- **Getting Electricity:** The Island's energy supply is costly and unreliable
- **Dealing with Construction Permits:** Firms spend significant time (165 days), effort (22 procedures), and money (6.7% of project's future value) to obtain permits, on average
- **Registering Property:** Companies must invest significant amounts of time (190 days) and effort (eight procedures), on average, to register property
- **Paying taxes:** Firms spend significant time (218 hours) completing filings (16 payments), on average, and are much likelier to be audited than on the mainland
- **Occupational licensing laws:** Excessive regulations have restricted labor force participation and constrained economic activity
- **Freight regulations:** Inefficient regulations have inflated transportation costs for businesses across the Island
- **Offshore investment attraction:** Inadequate Government oversight and resourcing have inhibited efforts to attract investments
- **Tourism attraction:** Insufficient Government funding and a narrow mandate undermine the Destination Marketing Organization's efforts to transform Puerto Rico into a leading tourist destination

The Governments' efforts to implement ease of doing business reforms have been at best insufficient to compete with other destinations improving faster. At worst, ease of doing business reforms have been rare and not radical or thorough enough to warrant improvements in scoring or in investor attitudes. Notwithstanding the need to replace previous competitive advantages to attract investment and the creation of jobs, the implementation has been uneven and minimal.

As such, when compared to the May 2019 Fiscal Plan, delayed implementation of ease of doing business reforms has delayed the impact on forecasted GNP growth by two years to FY2025 and reduced the uptick (by 0.10%) to 0.30%. Continued Government inaction will further jeopardize projected growth.

Power Sector Reform (Chapter 11)

An affordable, reliable, safe, and resilient electric power service is essential for the island's economic growth and development. Electricity is a fundamental enabler of the people of Puerto Rico's livelihoods, and remains a critical service that needs to be safeguarded, particularly in light of the outsized catastrophic events in 2020 (e.g. January 2020 earthquakes, COVID-19 pandemic). And as an important element of household and business activity, electricity is also a critical factor for attracting and maintaining investment in Puerto Rico. The Puerto Rico Electric Power Authority (PREPA) has been responsible for providing electricity to Puerto Rico since 1941 and is a public corporation owned and operated by the government of Puerto Rico.

However, PREPA has been encumbered by numerous financial and operational issues. Over the years, PREPA has failed to update rates to cover base operating costs, neglected to invest in modernizing the system, avoided funding the pension system, and failed to provide customers with reliable services. Furthermore, PREPA incurred significant legacy debt obligations, failed to implement a long-term capital improvement program, and made decisions based on short-term political gains (e.g., avoiding modest rate increases), all of which have culminated in consistently poor and unreliable service.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

This operating model has created an untenable financial situation for PREPA. Politicized management and volatile fuel prices – exacerbated by declining demand and an economic contraction – have resulted in PREPA's inability to service its debt, and ultimately resulted in PREPA seeking PROMESA Title III bankruptcy protection in July 2017. For more than a year prior to filing for bankruptcy, PREPA lacked access to the capital markets to help fund grid and generation modernization investments, further contributing to the poor quality of service experienced by the island's residents and businesses.

Underinvestment and underdevelopment of the grid, poor maintenance practices, and workforce losses all contributed to a chronically poor performing power sector. Puerto Rico has twice as many forced outages as the US industry average. PREPA also significantly underperforms against mainland utilities on multiple operational, reliability, and customer service metrics:

- PREPA's 2018 reliability metrics lagged behind those of US utilities in every area: SAIFI and SAIDI metrics (frequency and system average interruption duration respectively) fall within the worst-performing 20 percent and 50 percent of US utilities, respectively, and CAIDI is the third-worst out of 1,116 peer US utilities.

- Safety incidents are high by utility standards: PREPA recorded 10.7 safety incidents per 200,000 hours of labor in 2018 versus the US average of 1.7.

- Even though tree-trimming conditions caused 35 to 45 percent of service interruptions in 2016, PREPA lacks a comprehensive vegetation management strategy and has been slow to spend the allocated FY2020 budget for vegetation management. In contrast, vegetation management is typically the largest spend category in US mainland utility operating budgets.

Over the next five years, the power sector in Puerto Rico must continue its transformation and modernization to support the delivery of reliable and affordable power. The Commonwealth must continue to implement a comprehensive energy sector reform to enable a successful transformation and unlock the resulting growth from Fiscal Plan projects. The successful transformation of Puerto Rico's power sector depends on:

1. **Implementing Regulatory Reform:** A strong and independent energy sector regulator is essential for injecting certainty and stability into the energy market, promoting much needed investments, and enforcing compliance with the energy sector transformation's objectives. In recent years, the framework of regulatory reform has been approved and an independent regulator (i.e., PREB) has been established. The focus in coming years will be continuing to support the independence of the regulator and enabling the regulator to execute on its mandate. This will be accomplished by developing and strengthening the regulatory framework and promoting greater transparency and accountability.

2. **Transitioning the Operation and Management of PREPA's Electricity Grid and Generation Assets to Private Operators:** Attracting a private operator to manage and operate Puerto Rico's Transmission and Distribution (T&D) network will improve operational performance and customer service, support rigorous capital project execution to modernize the system, strengthen grid resilience, and ensure ongoing fiscal balance and control. In early 2019, Puerto Rico's Public-Private Partnership Authority (P3), began an ongoing process to evaluate potential private operators to assume responsibility for managing and operating the T&D system. A similar process will be undertaken to select potential private operator(s) of PREPA's generation assets.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

3. **Restructuring Legacy Debt Obligations:** In order to fund the transformation of Puerto Rico's power sector, PREPA will require access to capital markets. Given the utility's significant legacy debt obligations, a sustainable restructuring plan is necessary for PREPA to exit bankruptcy and regain access to credit. Without restructuring, customers will experience higher rates, resulting from repayment of a higher debt burden and risk premiums associated with bankruptcy. Ultimately, successful restructuring of outstanding bonds and debt obligations will allow PREPA to achieve its transformation goals, thus modernizing Puerto Rico's power grid, and passing on subsequent efficiencies and cost savings to end users.

PREPA's Fiscal Plans and the government of Puerto Rico's energy sector regulations lay out the transformation road map. If successfully implemented, a reformed energy system will lead to a modernized and reliable energy service across the island: a diversified fuel mix and reduced fuel costs, anchored on low-cost generating resources which reduce price volatility; increased operational efficiencies; and a well-funded, financially sustainably utility. These outcomes will benefit the customers and businesses of Puerto Rico in enabling a more affordable, reliable, and safe electricity service.

Infrastructure Reform (Chapter 12)

Relative to the mainland US, Puerto Rico's infrastructure outcomes rank near the bottom in terms of quality. For example, the percentage of road pavement in good condition is 11% in major highways and 1% in smaller traffic arteries, significantly underperforming the average of the mainland US (81%). The poor state of transport infrastructure has contributed to congestion and thus impacted the ease of doing business on the Island. Improving the efficiency and effectiveness of infrastructure and capital investments is critical to improve mobility on the island, increase convenience for residents, and lower the costs for business. Improving these outcomes will enhance the island's competitiveness and the ability to attract and retain population and investment.

Current state of Infrastructure and Capital Investment

Infrastructure investment as a percentage of GDP decreased from 3.3% in 2000 to 1.2% in 2018, indicating a lack of recent experience in large-scale building. The Government also has a history of failed large-scale projects. For example, Tren Urbano was scheduled to open on July 1, 2001 after beginning construction in 1996; it finally opened in 2005 and the budget for the project increased more than 60%, from $1.38 billion to $2.25 billion.

In addition to the challenges with infrastructure delivery and maintenance, the poor state of transport related infrastructure is a key constraint on mobility. Puerto Rico is ranked 51st out of 52 jurisdictions for quality of roads (percentage of roads in poor conditions), while urban congestion is particularly problematic in the San Juan metropolitan area and on major highways. San Juan is the 25th most congested city in the US according to the INRIX 2019 Traffic Scorecard Report with 46 hours yearly lost per driver in congestion during peak commute periods compared to free-flow conditions, resulting in ~$400 million of annual commuter cost.

Improving traffic on major highways, such as PR-52 and PR-18, is critical to enhancing growth. A 25% reduction in travel time for trips coming into and out of the central business district can reduce travel cost by over 6% (NCHRP Report 463). Investments to reduce congestion should prioritize the most economically important trips or provide alternative travel capacity to enable access despite congestion (Sweet, 2013). Targeted investments, such as "smart intersections", dynamic tolls and reversible lanes using movable barriers will reduce delays on key routes and journeys and facilitate economic growth.

However, Puerto Rico still has a lot of work to do in order to transform its transportation delivery organizations, enabling them to meet the standards set by other states in the US mainland. Such a transformation effort would mainly revolve around the following key initiatives:

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

1. Prioritizing projects with the highest long-term benefit-cost ratios, taking into account a variety of monetizable and non-monetizable benefits

2. Systematically leveraging private sector capabilities to improve overall public outcomes, thereby supporting and growing the private sector as well

3. Promoting the creation of a unified transport system for the San Juan metropolitan area through an integration of public transit agencies and a closer collaboration with private network operators

Transforming Government to Better Serve the Island

In addition to structural reforms, the Government must also implement fiscal measures to create a sustainable fiscal future for Puerto Rico. Fiscal reforms should reduce costs while maintaining or improving the quality of important services. The wide range of government efficiency initiatives shall target an increase in revenues through new and more efficient collections activities, while decreasing government expenditures by ensuring reasonable usage of resources.

While the Government has successfully maintained balanced budgets established by the Fiscal Plans, it has been slow to make meaningful progress regarding the necessary measures to sustainably reduce the cost of operations by transforming its processes and organizational structures. This has created a precarious risk to government service delivery, especially given recent earthquakes and the COVID-19 crisis, when Puerto Rico's population is more reliant on the Government to provide them the public services effectively and efficiently that enable life to proceed and the economy to recover. While the Oversight Board continues to believe that incremental government efficiency measures included in the 2020 Fiscal Plan are of the utmost importance for the Island to establish a solid foundation for the future, the Oversight Board also recognizes that given the complexity of the situation and lack of progress in implementation to date, pausing new measures for a year will provide time to focus all efforts on implementation of the changes that need to be effected. The Oversight Board urges the Government to re-commit to identifying and driving initiatives that will result in better processes, more efficient spending, and greater quality of service for the Island. The 2020 Fiscal Plan also introduces the concept of milestone budgeting, which provides incentives for achievement of longstanding key fiscal goals and efficiencies. For example, the Department of Corrections will receive additional budget allocations for FY2021 capital expenditures once it has provided an outline for its facility footprint and consolidation assessment study.

Agency Efficiencies (Chapter 13)

In accordance with Section 201(b)(1) of PROMESA, the Fiscal Plans for Puerto Rico "provide a method to achieve fiscal responsibility and access to the capital markets." When the Fiscal Plan process began in 2017, the Government had approximately ~116,500 employees across 114 Executive Branch government agencies, as well as agencies within the Legislative and Judicial branches (excluding large instrumentalities, e.g., PREPA, PRASA, HTA UPR, COSSEC, GDB). These agencies **were ineffective and inefficient in delivering the services needed by the people of Puerto Rico, while consuming resources that were outsized compared to the population served**. Even now, compared with states serving similar populations, Puerto Rico remains an outlier in terms of sheer number of agencies. For example, as of 2018, Iowa only had 36 state agencies and Connecticut had 78. Staffing and managing an organization of this size is challenging even in a stable economic environment. With over 100 direct reports to the Governor, it has been a practically impossible management task. **In addition, notwithstanding the amount of spending, there are countless examples of subpart service delivery across the Government.** For instance, despite having six agencies primarily dedicated towards the financial stewardship of the Island, the Government has been unable to consistently issue consolidated audited financial statements on a timely basis. Further, Puerto Rico's education system has a record of consistently delivering unsatisfactory student outcomes, including below- US mainland average graduation rates and standardized test scores that are far below basic proficiency levels.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

To assure the delivery of essential services while achieving financial sustainability**, the Government must focus on operational efficiencies to enable better service delivery in a cost-effective way.** A leaner, more efficient, and transformed future Government of Puerto Rico should wherever possible reflect mainland US benchmarks in terms of both number and size of agencies.

As part of the new Government model, the Government should consolidate the 125 agencies into no more than 44 agency groupings and independent agencies. In some cases, these consolidations should better focus the competing efforts of multiple agencies, such as the Economic Development grouping, which is consolidating ten agencies into one. In other cases, the consolidations should serve to move services closer to residents, such as the Healthcare grouping, which will consolidate access points to important services like Medicaid. Additionally, consolidations will enable agencies to streamline back-office processes, eliminate duplicative resources and benefit from procurement efficiencies.

In addition to agency consolidations, the Fiscal Plan outlines operational and process improvements that must be made to more efficiently use resources—including staff, equipment, services, and buildings—across agency groupings such as Education (PRDE), Corrections (DCR), Health (DOH), and Public Safety (DPS). The goal of such efficiency measures is to improve the quality of the underlying services for the population while also directing valuable resources toward priorities and achieving the cost savings needed to balance the Government budget.

These measures were developed through an iterative process with the Government and are designed to ensure compliance with necessary savings targets without compromising the quality of public service delivery on the Island—and actually improving it in many cases. These measures include various agency-specific efficiency (rightsizing) measures as well as certain government-wide savings measures:

- ***Agency-Specific Personnel Measures***: Personnel efficiencies specific to each agency (such as back office consolidation, process re-engineering to enable headcount rightsizing and align resources with mainland US state benchmarks) that will enable the reduction of payroll expenditure levels

- ***Agency-Specific Non-personnel Measures***: Operational efficiencies specific to each agency (such as procurement centralization and optimization of spend, consolidation of facilities) that will enable the reduction of non-payroll expenditure levels

- ***Government-wide Compensation Measures***: Standardization of personnel policies throughout government (including institution of common healthcare benefits, a hiring freeze, and limited holiday pay, as well as elimination of the Christmas bonus and carryover of sick/vacation days beyond the statutory caps) to enable the reduction of payroll expenditures across agencies without reducing additional employees

- ***Government-wide Non-Personnel Measures:*** Energy efficiency improvements and conscious usage of electricity and water (e.g. PREPA and PRASA), resulting in savings on utility expenses. Further, reductions to professional services to enable the professionalization of the civil service and reduce reliance on outside consultants. Finally, elimination of 'englobadas' or less transparent spending, which impacts fiscal controls and accountability.

- ***Investments and Other Funding:*** Agency-specific one-time or recurring funding provided by the Fiscal Plan to ensure Government agencies can meet federal requirements, provide quality front-line service delivery, respond to COVID-19, and focus on implementation of efficiency measures.

To date, the Government has unfortunately not demonstrated meaningful progress in implementing agency consolidations or otherwise improving operational efficiency, though they have generally met budget targets.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

To achieve personnel savings, the Government has primarily utilized broad-based early or incentivized retirement programs (e.g., the Voluntary Transition Program and Voluntary Pre-Retirement Program (Act No. 211-2015, as amended)), instead of driving optimization of back-office roles (e.g., through reduction of duplicate administrative roles in DCR or centralizing back-office operations in OCFO) or initiatives to align front-office roles with benchmarks from mainland US states (e.g., State Elections Commission personnel). The Government's efforts through these untargeted retirement programs have led to large payouts with high retirement rates, major gaps in skills and capabilities, and a slower, less effective government, often encouraging needed personnel to retire early.

To achieve non-personnel savings, the Government has made little to no changes in the procurement processes or the organization of operations. While the Government has reported its intent to centralize procurement (within GSA), consolidate the number of contracts across agencies, and consolidate physical locations of operations, inefficient spending often continues longer than necessary (e.g., utility expenses at closed schools have largely continued even though the school is unused, and officers continue to be staffed to guard closed correctional facilities).

While this approach enabled the Government to meet budget targets in FY2019, it has prevented meaningful progress towards more effective or sustainable agency operating models. Without changing the way services are delivered and/or determining which non-priority government activities will be discontinued, simply reducing headcount risks exacerbating already outdated government operations. Going into the next fiscal year (FY2021), this approach to personnel reductions would lead to a need for agencies to take drastic actions (e.g., decreasing the accessibility or quality of services offered, or slowing or altogether halting important services) given no rethinking of delivery has accompanied the reduction in staffing. This was not the intent or the requirement of the Fiscal Plan. Clearly, this creates a precarious risk for the population, especially given recent earthquakes and the COVID-19 crisis, which both mean that Puerto Rican residents are further reliant on the Government to provide them the public services effectively, efficiently, and promptly that enable life to recover and continue.

Thus, while the Oversight Board continues to believe that the fully outlined efficiencies are of the utmost importance for the Island to have a solid foundation for the future, the Oversight Board also is cognizant that, given the current circumstances, the Government will need to invest time and effort in achieving the measures previously required and not yet implemented, while supporting Puerto Rico residents. Therefore, the 2020 Fiscal Plan has paused incremental agency efficiency measures until FY2022. The expectation is that this one-year pause will enable the Government to redouble its focus on implementation of the efficiency measures not implemented to date.

The Oversight Board is also including implementation budget incentives in FY2021 to encourage accelerated implementation of reforms that would bring Puerto Rico a step closer to a sustainable government. There are six affected agencies: PRDE, DCR, DDEC, DOH, Hacienda, and AAFAF. In select priority areas in which agencies implement certain required actions – including but not limited to meeting higher data quality and transparency standards, conducting operating model/capacity analyses, or building up essential infrastructure to facilitate process improvements – incremental budgetary resources are available for the implementing agency. Detailed descriptions of these implementation budget incentives are included in the required implementation actions detailed for each agency later in this chapter.

Office of the Chief Financial Officer (OCFO) (Chapter 14)

One of the key goals of the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) is for fiscal accountability to be quickly and permanently ensconced in the Government. To fulfill this goal, the Government must create a strong Office of the Chief Financial Officer (OCFO). By centralizing key financial management functions (e.g. procurement, payroll) under a capable and well-resourced OCFO, the Government must address long-standing issues that have arisen under the Island's historically decentralized financial management regime.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

These include persistent difficulties around understanding the financial needs and priorities across Government as a whole based on transparent data, timely and accurate consolidated reporting, preventing the misallocation of funds, preventing agencies from overspending their budgets, control over opening and managing bank accounts, and timely consolidated financial statement issuance. The creation of a centralized OCFO was a linchpin in the restoration of fiscal responsibility of several public entities, including the District of Columbia following its financial crisis in the mid-1990's and the City of Detroit in its Chapter 9 bankruptcy. The Oversight Board strongly stands behind the need for a centralized OCFO to place the Island on a fiscally responsible economic trajectory and restore its access to the capital markets as required by PROMESA.

The Government's efforts to create a highly-capable OCFO have been slow and disjointed. However, progress has been made in certain areas, including providing bank account transparency, weekly publication of emergency reserve reports, monthly reporting of budget-to-actuals for select Government agencies and publishing of the 2017 tax expenditure report published in September 2019. While the enhanced reporting yields some improvements in management and oversight capabilities, there is a need for more detailed reporting in several areas (e.g., payroll and attendance as well as consolidated reporting for PRDE, detailed monthly budget to actuals on component units, etc.). In essence, each relevant financial agency has improved operational capacity and accountability somewhat, but there has been little centralization and responsibilities remain unclear within the group. Operating without a strong legislative mandate, the OCFO has moved from Hacienda to AAFAF throughout FY2020. While OCFO has made recent efforts to produce more granular budgets and create detailed agency-level budget-to-actual spending reports, it has been substantially delayed in the issuance of the Government's Comprehensive Annual Financial Reports (CAFRs) (as of May 2020, the FY2017-FY2019 CAFRs have not been issued). Key financial management and administrative functions remain distributed across a half-dozen Government agencies, and the Government has yet to legislate the OCFO's organizational and governance structures or adequately staff the organization to fully execute its oversight responsibilities. Without comprehensive action, the Island's financial management capabilities will continue to fall short of best practices, the expectations of the capital markets, and the needs of the Puerto Rican people. As such, the OCFO should assume all key financial management functions across the Government—necessary to place the Island on stronger financial footing.

The core objectives of the consolidated OCFO must be to:

A) Centralize treasury and liquidity management to:

- Enforce and manage a consolidated Treasury Single Account (TSA) for the Government that controls and offers visibility into all Government bank accounts (to the extent possible), including those of component units (CU) at private banks

- Enable all other public entities to maintain zero balance sweep accounts

- Empower OCFO to serve as the sole authority for Government bank account creation and closure—facilitating liquidity reporting, monitoring, and analysis

- Facilitate the rationalization of the Government's account portfolio to support maximization of earnings, cash pooling, daily cash sweeps and treasury operations, and implementation of uniform accounts payable and disbursement prioritization processes and reports

B) Enhance budget development process by improving monitoring and performance tracking to:

- Comply with the recently-issued Oversight Board budget guidelines and timeline to develop an auditable budget that is readily-traceable to Certified Fiscal Plan

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- Forecast and manage the seasonality of tax receipts
- Forecast and report the fiscal cost of tax credits
- Oversee all tax decrees and tax agreements issues
- Operationalize the financial system budget to ensure consistency between accounts and facilitate their monitoring
- Estimate, protect, and enhance tax collections and revenue streams
- Establish budgetary priorities-namely, effective expenditure controls and Government-wide procurement reforms

C) Driving the standardization and integration of the Government's financial IT systems to:

- Identify disparate systems being used for financial tracking and reporting
- Establish a roadmap to standardize and integrate systems to the fewest possible
- Orchestrate the integration across agencies, including defining new policies and procedures, coordinating data migration and validation, and training system users to effectively utilize new systems

  The Oversight Board encourages the Government to evaluate current laws which exempt certain government entities from the Puerto Rico Government Accounting Act. Regardless, while some entities are mandated by law to maintain fiscal independence, these entities could still leverage central financial IT systems to reduce costs and automate current processes.

D) Ensure compliance with procurement, contracts, pensions, and human resources management policies across Government agencies to:

- Certify all contracts, bills, invoices, payroll charges, and other evidences of claim, demand, or charge relating to the Government and entities reliant upon its taxing authority by prescribing receipts, vouchers, and claims for all agencies to leverage
- Manage centralized health insurance procurement and policy management
- Oversee human resources, Government payroll operations, and all Government-related financial transactions
- Implement uniform time, attendance, and overtime processes, payroll controls, and reporting standards

- **Strengthening oversight of Special Revenue Funds (SRF) through enhanced control mechanisms to:**
  - Implement processes that improve stewardship of all SRF
  - Ensure all revenue streams attributable to SRF are deposited within the TSA

- **Improving the timeliness of the Government's Comprehensive Annual Financial Reports (CAFR) and financial reporting to:**

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- Produce high-quality CAFRs that follow the modified-accrual basis of accounting required by PROMESA and leverage new forecasting, e-settlement, and analytics capabilities for FY2018 onward within established regulatory timeframes

- Publish the FY2017 CAFR and provide a draft of the FY2018 CAFR by November 2020

The 2020 Fiscal Plan provides for a one-time bonus of $1,500 to each Hacienda Central Accounting employee if Hacienda both (i) publishes and issues the FY2017 CAFR and (ii) provides a draft of the FY2018 CAFR by November 30, 2020.

- Identify and resolve drivers of historic CAFR publication delays to ensure FY2020 and beyond publications can occur within six months of a fiscal year end

- Support stronger implementation forecasting of measures required by the Certified Fiscal Plan and more robust reporting of actuals

- Supervise property tax assessment reforms, prepare tax maps, and provide notice of taxes and special assessments

• **Centralizing and validating the management of Government funds, debts, and other financial transactions to:**

- Maintain custody of all public funds, investments, and cash

- Administer cash management programs to invest surplus cash

- Facilitate short- and long-term borrowing programs

- Establish accountability over all Government funds, property, and assets

- Oversee all tax decrees and agreements issued

- Publish an annual Tax Expenditure Report that identifies and quantifies all tax expenditures240 (initial report published in September 2019 for tax year 2017)

• **Overseeing the Implementation of the Certified Fiscal Plan to:**

- Enable all Government agencies to comply with efficiency measures stipulated within the Certified Fiscal Plan

- Facilitate timely and targeted interventions to address areas of underperformance relative to efficiency measures

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Medicaid Investments and Reform (Chapter 15)

In 2019, ~37% of Puerto Ricans received their health coverage through the Commonwealth's state-run Medicaid program; this was the highest share of Medicaid/CHIP-funded health insurance coverage of any US state. In addition to its large, covered population, Puerto Rico has lagged mainland states in both health outcomes and access. Puerto Ricans face higher rates of chronic conditions like hypertension (12.4% above national median), diabetes (4.5% above national median), and asthma (1.6% above national median) than national averages. Puerto Rico also has higher premature birth and infant mortality rates, and higher rates of adults reporting fair or poor health. At the same time, 72 of Puerto Rico's 78 municipalities are deemed "medically underserved areas," with 500 doctors leaving per year (pre-Maria). Puerto Rico has half the rate of specialists (e.g., emergency physicians, neurosurgeons) as compared to the mainland in critical fields.

Puerto Rico's Government-funded health plan, Vital, covers individuals through three primary funding sources: federally-matched Medicaid funds, the Children's Health Insurance Program (CHIP), and the Commonwealth's self-funded insurance program for low-income adults who do not qualify for federally-matched Medicaid. An additional ~8% of the Puerto Rican population receives some benefits from the Government as part of the Platino program, which supports Medicare Advantage recipients who also qualify for Medicaid (also known as "dual-eligible").

Because federal Medicaid funding for US territories is subject to an annual cap, Medicaid expenditures eligible for federal matching exceed available funding without supplemental legislated sources. This makes Puerto Rico's Medicaid program very sensitive to rising healthcare costs. Since 2011, Puerto Rico has received temporary relief from rising healthcare costs through increased levels of federal reimbursement made available through the passage of the Affordable Care Act and the Bipartisan Budget Act of 2018. In December 2019, the Further Consolidated Appropriations Act was passed, which provided supplemental federal funding (up to $5.7B total) to Puerto Rico's Medicaid program through September 30, 2021 (first quarter in FY2022). In addition, the law raised the FMAP—the portion of Medicaid expenditures that federal funds can cover—from the standard level of 55% to 76% for most populations. In response to the COVID-19 pandemic, the Families First Coronavirus Response Act was passed in March 2020, further increasing both the available federal funds (adding an additional $183M) and the FMAP (increased an additional 6.2% for most populations). The available supplemental federal funds and higher FMAP will both return to standard levels in October 2021 without new federal legislation. Accordingly, the Commonwealth will hit a "Medicaid fiscal cliff," whereby it will be responsible for multi-billion-dollar annual healthcare expenditures that had been covered by federal funding since 2011.

It is crucial, therefore, that ASES take advantage of the additional runway provided by recent federal legislation to put in place reforms that reduce the long-term growth rate of healthcare expenditures. Given the uncertainty as to future federal reimbursement levels, the 2020 Fiscal Plan assumes that no further supplemental funding will be provided beyond current programs, and thus, the Commonwealth must be prepared to cover growing Medicaid costs as if federal reimbursement rates revert to steady-state levels.

Tax Compliance and Fees Enhancement (Chapter 16)

Puerto Rico's current tax system suffers from its structural complexity, instability, internal inconsistency, inefficient administration, and inadequate enforcement. There have been at least 11 major revisions to Puerto Rico's tax code since 1994, including at least six adjustments since 2013. This has allowed for persistent problems with non-compliance, worsened by a lack of an integrated approach to addressing non-compliance. Top marginal tax rates are high relative to US federal and state taxes. Much of the Government's revenue is highly concentrated in collections from a handful of multi-national corporations. The Government has also issued an assortment of credits, deductions, and incentives that add to the system's complexity and further erode the tax base. Furthermore, audit and enforcement activity in recent years has been limited, which creates risks of increased levels of non-compliance.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Due to its compliance and collections issues, the Commonwealth has not been able to collect as many revenues from taxes as it should each year.

In response to these challenges, the Government has taken actions to improve tax compliance. It has taken steps to improve information reporting to better detect under-reporting of income and over-usage of deductions and credits, notably through recent changes to information reporting requirements included in Act No. 257-2018. These changes create greater interdependencies among taxpayers and the information they are obligated to report, which is expected to enable greater oversight and verification of the information being reported to the Government. Enhanced usage of data can help Hacienda better isolate risk and focus its compliance and enforcement resources. It is driving improvements in its culture and organization to boost enforcement capabilities, and digitizing the process of filing taxes, to lighten the burden of compliance on taxpayers.

With the publication of the first Tax Expenditure Report in September 2019 (see *Section 16.3.1*), policymakers now have the data necessary to review, assess, and adjust the use of individual tax expenditures to ensure that these foregone revenues are leading to positive economic development on the Island.

Improve Compliance Rate

The Government must continue its efforts to achieve a target 5% net uplift in annual revenues due to enhanced compliance by FY2023 across the major tax lines (personal income tax, corporate income tax, and SUT) – inclusive of implementation costs. Such an improvement would be in-line with improvements seen in other tax transformations. This improvement would be relative to a reduced baseline estimate of revenue collections due to the impacts of COVID-19, and expanded impact would not be expected to resume until FY2022.

Hacienda should continue to take a variety of initiatives that can boost voluntary compliance. The goal should be to reduce the cost of compliance while simultaneously raising the cost of non-compliance, through a combination of an increased likelihood of being caught while not paying taxes owed and more effective and enforceable penalties.

- Use new systems and processes to identify and remediate non-compliance. Hacienda has taken steps to make it harder to abuse deductions and credits to avoid tax liability, for example by only allowing taxpayers to claim certain deductions and exemptions if their return is prepared by a certified public accountant following agreed upon procedures.

- Reduce the complexity of the tax system and process of filing taxes to make it easier for individuals and businesses to pay their taxes correctly. As detailed further in *Section 10.4*, improving the process of for filing and paying taxes is critical for improving ease of doing business, but it also helps boost voluntary compliance.

- Improve use of data and analytics to address non-compliance. Small and medium taxpayers account for a significant share of the unpaid and underpaid taxes, but only a tiny fraction of these taxpayers receive full-scale audits due to the significant time and cost investment needed. While a traditional IRS audit costs an average of $2,278 per case, automated notices or letters can be executed for $52 to $274 per case. Hacienda is receiving increasing filings of information returns that can be used to better identify risk and focus compliance resources. Implementing data-driven, tiered compliance approaches over time will enable Puerto Rico to reach a significantly larger share of nonpayers.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- Collecting SUT on Internet sales. Nationally, the percentage of taxpayers voluntarily reporting and paying sales and use taxes on their income tax forms ranges from 0.2% to 10.2%, while nearly 80% of Americans shop online. Mainland states have taken steps to improve sales tax collections on online sales through legislation, as well as voluntary agreements with major online retailers. In its 2018 *Wayfair* decision, the US Supreme Court further provided mainland states with parameters under which sales taxes could be levied on out-of-state sellers. Given these trends, the Government should also be working to capture SUT on a much larger share of Internet sales. Hacienda has announced agreements with some online retailers to charge Puerto Rico SUT on Internet sales of goods. With Internet sales growing at ~15% annually, and growth expected to accelerate further as the COVID-19 pandemic makes the internet a critical component of consumer purchasing habits, Internet sales tax presents an even more important opportunity going forward.

The impact from these compliance related activities is projected to phase in over the course of four years. In light of the challenging economic climate anticipated in FY2021, the 2020 Fiscal Plan does not forecast incremental increases in revenue yield until FY2022, though Hacienda will continue to implement its compliance-related initiatives.

Right-rate Other Taxes and Fees

Prior to Hurricane Maria, the Government reported that it had already developed a plan to right-rate certain taxes and fees. These original plans, as well as any adjustments mutually agreed upon between the Government and the Oversight Board during implementation of the March 2017 Fiscal Plan, have been largely included in this 2020 Fiscal Plan, except where explicitly noted below.

Despite multiple pieces of enabling legislation, the Government's approach to implementation lacks central accountability, with specific actions and timelines. Progress against these measures has been uneven and the Government must urgently make progress to close the gap.

Gaming tax. Legislation passed in 2017 increased licenses and fees on mechanical and electronic gaming machines to $3,000 from $100. This was originally estimated to generate ~$71 million in incremental revenues. Part of this calculation involved assumptions of improved enforcement, as the Government has previously estimated that it is losing approximately $170 million per year due to illegal machines that are not paying licensing fees. However, when factoring in the potential that a 2,900% increase in taxes on the machines could decrease total revenues from gaming, the Fiscal Plans adjust the required revenues to be approximately $46 million.

Licenses and other fees. 2017 legislation enabled fee increases in miscellaneous categories. Hacienda will determine which exact fees are to be increased to meet these minimum thresholds, achieving an overall revenue increase of ~$57 million per year. Categories are as follows: Charges for services; Fines; Insurance; Licenses; Permits; Rent; Royalties; Stamps; Other.

Tobacco taxes. Legislation was passed in 2017 to increase specific tobacco taxes, including taxes on cigarettes, cigars, rolling tobacco, cigarette paper and tubes, chewing tobacco, snuff, electronic cigarettes, nicotine cartridges, and vaporizers. Accounting for one-time declines in use due to price elasticities after the new law went into place, a ~$52 million per year increase by FY2024 in revenues due to the new taxes is required. In order to give the Government time to focus on a comprehensive implementation approach, the required revenues are delayed until FY2022.

Medical marijuana tax. Legislation has been enacted to tax medical marijuana. Based on an estimated 29,000 patients, the Government expected to collect approximately ~$13 million per year in additional revenue through this initiative.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Airbnb Tax. Legislation has been enacted to apply a 7% hotel room tax to Airbnb rentals, resulting in a projected annual revenue increase of ~$3.5 million This revenue stream will be substantially impacted by the reduction in demand due to COVID-19, recovering only as the tourism sector rebounds.

Reduction in Appropriations to UPR (Chapter 17)

The central Government provides a range of appropriations to three main groups of recipients: The University of Puerto Rico (UPR), Puerto Rico's 78 municipalities, and "other" recipients (typically private industry or non-profit institutions).

The University of Puerto Rico, founded in 1903, is Puerto Rico's largest and main university system. Its mission is to serve the people of Puerto Rico, contribute to the development and enjoyment of the fundamental values of Puerto Rican culture, and uphold the ideals of a democratic society. To advance its mission, UPR strives to provide high-quality education and create new knowledge in the Arts, Sciences, and Technology. UPR has a history of academic excellence, with 694 degree-granting academic and professional certification programs, including six first level professional degree programs and 34 PhD programs. The university system is also an important center of research; for example, the Rio Piedras campus is classified as a high research activity university by the Carnegie Foundation (one of only 335 US universities to receive such a designation) and there are 79 separate research centers across the university system. UPR also plays a critical role in providing avenues for social and economic advancement, with 68% of students receiving Pell grants.

In FY2018, UPR was 67% subsidized (~$678 million in annual appropriations) by state and local funds, compared to an average 25% state and local subsidization for US public universities. In FY2018, UPR's undergraduate tuition was less than one-third of the US average for public universities, even after adjusting for per-capita income, and more than 40% below the average tuition of private universities on the Island. Yet, during the past decade, UPR has seen a 24% enrollment decline (13% since FY2018) across both graduate and undergraduate populations. Moreover, UPR consists of 11 independent campuses with minimal shared services or administrative consolidation. As a result, UPR has grown reliant on the significant subsidies from the Commonwealth, and has made slow progress in addressing declining enrollment, diversifying its revenues, rationalizing its tuition and scholarship systems, renewing and maintaining its infrastructure, addressing operational inefficiencies, appropriately funding its pension system, and paying its contractually-obligated debt.

A reduction of the appropriation for UPR was determined in 2017 through a shared process with the Government to identify reasonable, sustainable measures to bring UPR closer to US mainland public university tuition and administrative cost benchmarks, while maintaining (and in many cases improving) the performance of the system, which serves as a primary economic growth engine of the Island. It reflects both the declining enrollment of the university as well as the sizeable opportunity to diversify revenue sources, transform operations through greater utilization of shared services and other administrative streamlining across its 11 campuses. In light of the COVID-19 pandemic, the Oversight Board has agreed to provide a one-year pause in the further reduction of UPR's annual appropriation to enable UPR to focus all its efforts on implementing the efficiencies previously required and not completed. The 2020 Fiscal Plan therefore maintains the UPR subsidy level at 54% in FY2021. Thereafter, a gradual decrease in the UPR appropriation will continue as previously envisioned to ~$452 million by FY2025.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Municipal Service Reform (Chapter 18)

Puerto Rico's 78 municipalities are also recipients of Commonwealth appropriations. To incentivize a new operating model between the territory and municipal governments, as well as municipal operational changes, prior Fiscal Plans reduced Commonwealth appropriations to municipalities. In FY2018, the total municipal appropriation was $220 million (a reduction of $150 million relative to the prior year). In FY2019, it was reduced to $176 million, and in FY2020, as stipulated in the 2019 Fiscal Plan, it was further reduced to $132 million. Over the past two years, however, there has been little meaningful progress on redefining the relationship between the territorial government and municipalities, almost no decentralization of responsibilities, and no expenditure-sharing. Moreover, municipalities have made little (if any) progress towards implementing the fiscal discipline required to reduce reliance on Commonwealth appropriations and better reflect a declining population in many areas. The lack of fiscal management is now being exacerbated by the COVID-19 pandemic, threatening the ability of municipalities to provide necessary services, such as health, sanitation, public safety, and emergency services, to their residents and forcing them to prioritize expenditures.

Over the last decade, Puerto Rico's population has declined by ~18% and it is projected to continue declining going forward. Given that and absent any other structural reorganization of responsibilities, municipalities must pursue consolidation of services across multiple municipalities to enable better and more efficient services for Puerto Rico residents. Moreover, consolidation would significantly reduce costs by leveraging scale, especially in areas of services provided directly to residents, such as garbage disposal and maintenance of municipal buildings and roads.

In any given year, less than half of the fully-reporting municipalities often recorded a positive Change in General Fund Balance due to budget shortfalls, and approximately 40% are dependent on Commonwealth appropriations to operate. From FY2010 to FY2018, these municipalities' aggregate General Fund balances declined from $55 million to negative $118 million. These repeated budget shortfalls put further financial strain on the following years, driving negative fund balances that have required persistent Commonwealth support and/or increased borrowing. As currently operating, many of the municipalities are not fiscally sustainable.

Given the lack of meaningful progress to date in achieving municipal government services reform and municipalities' financial challenges, particularly in the context of the Hurricanes, earthquakes, and COVID-19, the Government will need to develop a solution to streamline and consolidate municipal services throughout Puerto Rico. Otherwise, the Government faces the prospect of expanding municipal operating deficits, further deteriorating infrastructure, and worsening service delivery.

Since municipalities provide services that are, in most cases, complementary to those of the Government, the Commonwealth should take this opportunity to rethink the entire governmental structure, not just that of municipal governments. This will allow the Government to deliver better services across agencies in coordination with municipalities, and to do so more cost-effectively. A centralized approach has proven, repeatedly, to be inadequate for the management of various government programs in Puerto Rico. A new decentralized model could remove the bottleneck of centralized Commonwealth agencies, dramatically increasing capacity to respond to a crisis and improving service delivery at a local level. Unfortunately, the vast majority of municipalities do not (individually) have the administrative or financial capacity to operate Commonwealth programs. Many also lack the economies of scale necessary to be efficient with programs such as ASUME, ADFAN, or Vivienda. However, a consolidated municipal service structure could enable the delegation of certain Commonwealth responsibilities to local governments. Such a model could yield municipal and Commonwealth savings, and a portion of those savings could be reinvested back into the municipalities where savings are realized.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

In addition, a more integrated government structure could help implement locally-based economic development strategies, which are more viable at a regional level than on an individual municipality basis. On the revenue side, service consolidation could further enhance the coordination of property tax collection by standardizing and automating processes and integrating data and information systems.

Act No. 29-2019

On April 15, 2020, the Title III court issued a decision granting summary judgment to the Oversight Board on several of its claims against the Governor and AAFAF and nullifying Act No. 29-2019 as being in violation of PROMESA. The Title III court's order became effective on May 7, 2020. The effect of this nullification requires municipalities to cover their own employees' healthcare and PayGo costs. For FY2020, the PayGo and healthcare obligations are approximately $166 million and $32 million, respectively. The Oversight Board, the Government, and MRCC have agreed that the combined amount due, $198 million, will be partially offset by the FY2020 Commonwealth transfer of $132 million (that was transferred to MRCC in accordance with the 2019 Fiscal Plan and certified Budget). Under Act No. 29-2019, MRCC was retaining these funds, but remitted approximately $34 million to municipalities in lieu of property taxes as part of the monthly remittances. This was in violation of the 2019 Fiscal Plan and certified Budget, and the Commonwealth will recover these funds through the short-term liquidity facility described in *Section 18.2.3*. Therefore, MRCC must return the retained funds to the Commonwealth to be applied as a set-off against these obligations due. After accounting for the various transfers of funds, the nullification of Act No. 29-2019 results in the municipalities currently owing $66 million to the Commonwealth for their employees' FY2020 PayGo and healthcare contributions. This amount equates to approximately 3% of the total municipality General Fund budgets in FY2020 (~$2 billion), although the impact varies on a municipality-by-municipality basis.

The Oversight Board accepted MRCC's proposal to allocate the $132 million in equal proportion across municipalities. Under this option, every municipality will owe ~33% (representing $66 million of the $198 million total amount due) of its FY2020 PayGo and ASES obligations. These amounts will be repaid according to the repayment waterfall in *Exhibit 118*. This repayment waterfall focuses on incremental revenues that municipalities have not considered in their FY2020 budgets. Therefore, the financial impact on municipalities should be minimized.

Accelerating Post-Disaster Recovery at Municipalities

Puerto Rico has experienced historic and unprecedented disasters since 2017. The impact of Hurricanes Irma and Maria, as well as a magnitude 6.4 earthquake on January 7, 2020 (and the subsequent aftershocks), resulted in significant damage to the infrastructure and economy, and prompted material out-migration. The Federal Government has supported post-hurricane reconstruction in the municipalities primarily through FEMA's Permanent Work (Categories C-G) Small Projects and Community Disaster Loans (CDLs). Small Projects are defined as those with total project costs of up to $123,100 for Permanent Work Categories C-G. As of May 18, 2020, 1,224 projects have been obligated to municipalities, totaling ~$48.9 million, of which ~$33.5 million has been disbursed. In addition, 3,285 Small Projects are currently in the project formulation stage, with a total approximate cost of $152 million. CDLs are provided to municipalities that have suffered a substantial loss of revenues as a result of a disaster and that can demonstrate a need for federal financial assistance to perform critical functions such as payroll, supplies, and maintenance materials related to disaster operations. 76 of the 78 municipalities have received nearly $300 million from the Federal Government to make up for lost revenues due to the Hurricanes in the form of CDLs. Municipalities and the people of Puerto Rico have also received disaster funding through Individual Assistance programs, Small Business Administration Loans, Department of Housing CDBG-DR programs, and Department of Transportation funding.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

On December 7, 2019, the Oversight Board approved the Government's request to establish a "State Recovery Fund" that would fund advances to eligible Small Projects under the FEMA Public Assistance program, which many municipalities required due to a lack of liquidity. The State Recovery Fund was financed solely from a reprogramming of the $100 million FY2020 certified budget appropriation under the custody of OMB designated as "Cost share of public assistance" and is to be used only for Small Projects (as defined above). The Oversight Board also included several requirements from the Government as a precondition to approval of this State Recovery Fund. Since the establishment of this State Recovery Fund, COR3 has informed the Oversight Board that $92.5 million would be returned to OMB given other mechanisms have been put in place to expedite Small Projects and the funds are no longer required by the municipalities.

The 2020 Fiscal Plan includes the use of $9 million requested for the first required steps of demolition and debris removal as a result of the earthquakes in Guayanilla, Guánica, and Peñuelas, which are a prerequisite for redevelopment of the southwest region. As a next step, the Oversight Board urged the Government to determine what incremental efforts of this type are necessary in other municipalities (e.g. Ponce and Yauco) that have suffered from the earthquakes, and that these incremental requests be submitted for Oversight Board approval as soon as possible.

Beyond the first steps of demolition and debris removal, the next step should be the development of an integrated and comprehensive plan for the long-term economic reconstruction of the southwest region, focusing on rebuilding with resiliency and taking into account the changes in the economy in a post-COVID world, the patterns of migration from the area, and the potentially-permanent risks to populations from the earthquakes and erosion after the hurricane, among other factors. This plan should be developed in coordination with FEMA and other relevant agencies.

COVID-19 Crisis

In response to the COVID-19 crisis, the 2020 Fiscal Plan provides for a one-year pause in the further reduction of Commonwealth appropriations to municipalities; accordingly, the FY2021 appropriation will remain at $132 million (i.e., the same as in FY2020) rather than decline by $44 million as defined in the 2019 Fiscal Plan. This additional financial support for municipalities should be used to effectively implement strategies that will allow municipalities to improve their financial sustainability by instituting critical changes in operating structure, sharing costs through consolidated services, and improving revenue collection.

In addition, the Governor signed an executive order that adopts the "Strategic Plan for Disbursement" of the $2.2 billion allocated to Puerto Rico by the Coronavirus Relief Fund created by the Federal Government through the CARES Act, which assigns $100 million to be transferred to the municipalities for eligible expenses related to COVID-19.

Liquidity Facility

The onset of the COVID-19 pandemic resulted in the deferral of the personal property tax return due date as an emergency measure enacted by the Government. This extension has created a short-term liquidity challenge for MRCC and the municipalities for the remainder of FY2020 (May and June) and the first month of FY2021 (July). The Oversight Board approved a short-term liquidity facility of up to $185 million, funded by the Commonwealth, to ensure that MRCC can continue to advance monthly tax remittances to municipalities, which are crucial for municipal operations. This authorization will be in effect through July 31, 2020. The use of the liquidity facility is dependent on an approved budget that incorporates monthly municipal net remittances, payment of certain statutory and contractual debts, and MRCC operations. Repayment of the loan will come from basic property tax revenues received by MRCC, with receipts expected in August, September, and October 2020. This liquidity facility shall be repaid in full on or before November 30, 2020. The creation of a lockbox account will be required to protect the Commonwealth's collateral. In addition, MRCC will be required to provide both weekly and monthly financial reports regarding tax collection activity and financial statements, including income statements, balance sheets, and cash flow statements.

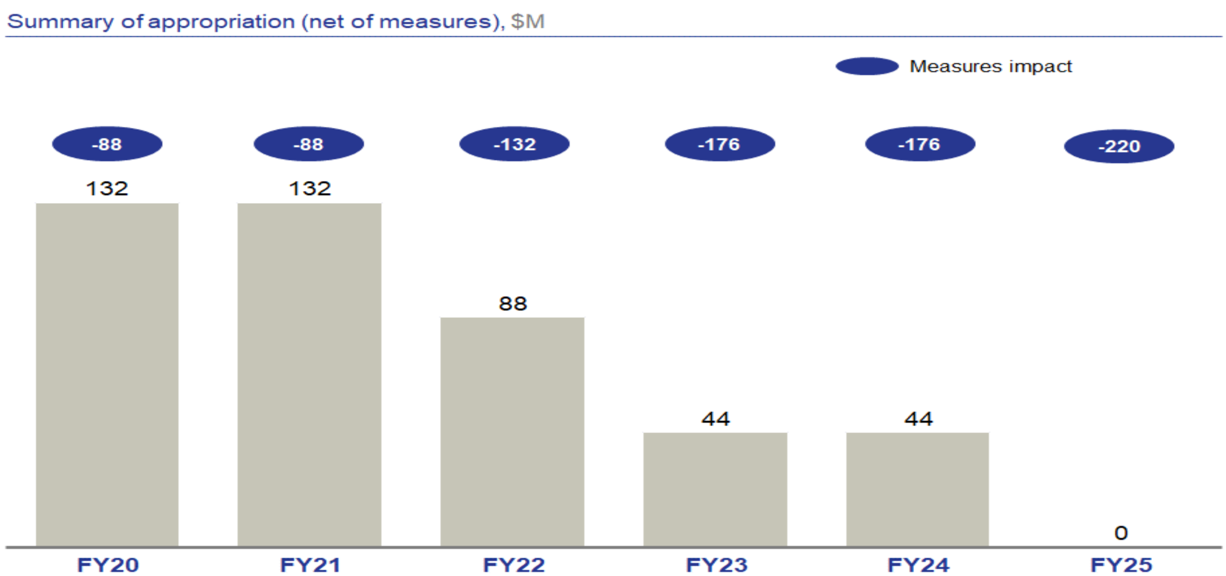
continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Incentivizing Consolidation of Services

To further incentivize service consolidation, the 2020 Fiscal Plan lays out a set of voluntary options for municipalities to consider. By consolidating services, municipalities will be able to significantly reduce costs. Under this approach, municipalities that voluntarily choose to consolidate services will be eligible to receive a one-time financial incentive upon certification of such action by the Oversight Board. To fund this initiative, the 2020 Fiscal Plan sets aside $22 million in each fiscal year through FY2025 for distribution among municipalities that complete service consolidations, as confirmed by the Oversight Board. The amount distributed will be determined in coordination between AAFAF and the Oversight Board and will depend on the size of the municipality and the scale of service consolidation. The 2020 Fiscal Plan otherwise maintains the overall approach of phasing-out the entirety of municipal appropriations, which will reach zero by FY2025.

Exhibit 119 illustrates the reduction in municipal appropriations that would occur if voluntary consolidation of services is not pursued and the status quo is maintained.



Oversight Board's Municipalities Pilot Program

On May 9, 2019, the Oversight Board announced that all 78 municipalities would become covered instrumentalities under PROMESA, with the aim of securing their long-term fiscal viability. As part of the initiative, the Oversight Board selected 10 geographically-aligned municipalities for a pilot program to develop fiscal plans and budgets to be reviewed and certified by the Oversight Board.

The ten municipalities selected from the central and northern regions are Orocovis, Aibonito, Barranquitas, Cidra, Comerío, Villalba, Camuy, Isabela, Quebradillas, and San Sebastián. Each municipality is required to include spending reduction and efficiency measures in their fiscal plans. These measures may include inter-municipal shared services arrangements, programs to improve and optimize local revenue collection, economic development guidelines, and decentralization proposals, and the Oversight Board has offered technical assistance in this process. The pilot program will show the value of consolidating services in seeking to reduce expenses and achieve long-term fiscal viability.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Pension Reform (Chapter 19)

The Government operates three public employee retirement systems in Puerto Rico: The Employees' Retirement System (ERS), the Teachers' Retirement System (TRS), and the Judiciary Retirement System (JRS). The systems have different tiers of benefit formulas, some of which are traditional defined benefit pensions based upon years of service and final salary, while others are hybrid cash balance plans. Under the hybrid cash balance plans, employees have notional accounts credited with contributions and interest, and upon retirement, benefits are payable as an annuity. Different benefit tiers apply to employees based upon the year in which they were hired. Per the latest data available, each of the systems included the following liabilities:

- ERS: 242,000 total covered (119,000 active employees, 123,000 retirees and other beneficiaries); with $1.5 billion in annual benefits and $31 billion in total actuarial liability

- TRS: 79,000 total covered (35,000 active employees, 44,000 retirees and other beneficiaries); with $0.7 billion in annual benefits and $17 billion in total actuarial liability

- JRS: 878 total covered (364 active employees, 514 retirees and other beneficiaries); with $25 million in annual benefits and $0.7 billion in total actuarial liability

All employees have historically made contributions toward their benefits, albeit at different rates. Most regular government employees (including police officers as of January 1, 2020) also participate in Social Security, which includes both employer and employee contributions; most teachers and judges do not participate. Over many decades, successive governments have failed to adequately fund these retirement plans, and today the ERS, TRS, and JRS are nearly insolvent. In fact, Commonwealth PayGo expenditures to provide pension benefits are expected to continue constituting over 1/5 of General Fund expenditures without further action.

Act No. 106-2017

With Act No. 106-2017, the Commonwealth transitioned to a new PayGo pension system, liquidated assets to help fund benefits owed, and has moved the assets of recently hired TRS members (and future contributions of ERS members) into segregated accounts. Hybrid accounts of System 2000 members were not similarly moved into segregated accounts. The Commonwealth is still in the development stage of implementing true defined contribution (DC) retirement plans for these members who previously had hybrid cash balance accounts, but this process has experienced significant delays. There is a need for further action to ensure the long-term adequate funding of pension benefits; in addition, some of the current commitments have not yet been fulfilled (e.g., the transition to the new defined contribution system has not yet been completed).

TRS members hired prior to August 1, 2014 and all JRS members are currently accruing benefits under the defined benefit components of their retirement plans. ERS members and TRS members hired after August 1, 2014 have already transitioned to hybrid cash balance plans. TRS members hired after August 1, 2014 have subsequently had their hybrid accounts segregated from the DB plan by Act No. 106-2017. These segregated balances, along with ERS contributions made after June 30, 2017, are being transitioned to DC accounts with a targeted completion date of July 2020. **To avoid creating future pension liabilities and to adequately fund the pensions of both taxpayers and future retirees, the JRS and remaining TRS benefit accruals must be frozen by July 1, 2021.** Members will retain the benefits they have accrued to date, subject to the benefit reduction discussed below. Future benefits must be based on contributions and earnings in new defined contribution retirement accounts. This will result in consistent and equitable treatment across ERS, TRS, and JRS, where all employees will contribute to segregated DC accounts. Going forward, employees should have certainty that their contributions and investment returns will be safeguarded for the future through managing their own segregated accounts.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

8.5% Pension Benefit Reduction

Notwithstanding the reduction in expenditures throughout the Commonwealth's budget, contractual debt service remains unaffordable. Retirement plan participants, like other unsecured claimholders, therefore, face a reduction of up to 8.5% in the amounts paid to them by the Commonwealth. A reduction in pensions (with protections for participants close to the poverty level) is appropriate and necessary for the Commonwealth to achieve long-term fiscal stability. The goal is a balanced approach to restore fiscal health to Puerto Rico while ensuring that cuts to retirement benefits occur in a manner that protects any retirees from falling into poverty. The proposed reduction, while significantly smaller as a percentage reduction than those faced by other unsecured claims, including GO bondholder claims and General Unsecured Claims, will still represent a significant reduction in retirement income for many retirees.

This treatment is similar to the level of reduction in pension benefits relative to reductions faced by other creditors that has been seen with other government systems facing pension funding crises. Although the benefit reduction will be 8.5%, this reduction will not apply to those with monthly pension benefits of less than $1,200 per month and will not reduce anyone's monthly benefits below such level. Exhibit 124 illustrates the current distribution of participants by monthly benefit amount across the Commonwealth's retirement systems.

EXHIBIT 124: DISTRIBUTION OF BENEFIT AMOUNTS BY RETIREMENT SYSTEM

	ERS		TRS		JRS	
Monthly benefit amount	Number of pensioners	% of total pensioners	Number of pensioners	% of total pensioners	Number of pensioners	% of total pensioners
Up to $1,000	71,065	59.6%	12,634	27.6%	37	6.9%
$1,000 - $1,200	9,539	8.0%	3,932	8.6%	8	1.5%
$1,200 - $1,500	12,545	10.5%	8,728	19.1%	23	4.3%
$1,500 - $2,000	12,815	10.7%	7,648	16.7%	34	6.4%
$2,000 - $3,000	9,509	8.0%	12,436	27.2%	51	9.6%
Over $3,000	3,778	3.2%	322	0.7%	380	71.3%

Covering More Government Workers in Social Security

Currently, teachers, police officers, and judges do not participate in Social Security. They do not pay into the program, nor does the Government make a Social Security contribution on their behalf. Unlike other ERS members, teachers, police officers, and judges are entirely reliant on their government pensions for income in retirement. This places them at risk when government retirement plans are poorly funded. Effective January 1, 2020, police officers, who were similarly situated previously, began actively participating in Social Security.

These groups are exempt from Social Security because of the "Section 218" agreement between the Commonwealth and the Social Security Administration, which stipulates that certain government employees have wages that are includable for Social Security and subject to FICA taxes while others may be exempt from Social Security if they participate in a "qualified replacement plan." Section 218 of the Social Security law provides guidance as to what constitutes a "qualified retirement plan," such as a defined benefit plan with a minimum benefit level or a defined contribution plan in which total employee and employer contributions equal to at least 7.5% of employee wages. Teachers and judges are both in job classifications that, under the Section 218 agreement, are exempted if such a "qualified replacement plan" exists. Under the current TRS and JRS retirement plans, this requirement is met and, therefore, such employees are exempted from Social Security

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Covering these workers under Social Security will provide them with diversified sources of income in retirement, and Social Security's progressive benefit formula will provide a stronger safety net for lower-paid employees. Workers will typically earn greater retirement benefits under Social Security based on a 6.2% employee contribution and a 6.2% employer (government) match, than they would in a DC plan funded only with a 6.2% contribution. For example, a typical full-career government employee retiring with a salary of $35,000 will be entitled to a Social Security benefit of approximately $16,000, in addition to the benefit the employee builds in their defined contribution retirement account.

Social Security retirement benefits are only provided for those who have ten years of covered earnings. Therefore, it would not be worthwhile for older workers, who may not meet the ten-year threshold and do not have other employment in which they were covered by Social Security, to be covered under Social Security. For this reason, only teachers and judges *under the age of 45* shall be covered under Social Security. This can be accomplished without either an employee referendum or new federal legislation by freezing the TRS and JRS plans and reducing the defined contributions for current teachers and judges under the age of 45 and all future teachers and judges hired to an amount lower than the 7.5% required by Section 218.

This step will trigger mandatory enrollment in Social Security. Concurrently, lowering the employee defined contribution for younger workers will address the loss of take-home pay they would suffer by having to contribute the 6.2% Social Security payroll tax. This approach is consistent with the approach used to implement Social Security participation for police officers in FY2020.

The 2020 Fiscal Plan includes the enrollment of teachers and judges under the age of 45 in Social Security as of July 1, 2021, coincident with the plan freeze. At a further date, the Commonwealth may wish to take the necessary steps to provide the option for teachers and judges over the age of 45 to be covered under Social Security.

Ensuring Successful Implementation and Fiscal Controls (Chapter 20)

Developing a centrally-run PMO is an important step toward ensuring the implementation and tracking of the core operational transformation and agency efficiency measures that will achieve savings targets under the 2020 Fiscal Plan. The OCFO should serve as the central PMO with defined reporting to the Governor of all economic and transformation measures. The PMO should be run by OCFO senior leadership, regularly coordinate across OMB and OARTH, work directly and frequently with Agency PMOs, and report directly into the Governor's office. Individual Agency PMOs should be established with direct reporting to the OCFO PMO. Each agency head shall be responsible for developing and implementing a PMO structure that best fits their respective agency groupings. They are expected to coordinate across all agencies in their grouping, lead reforms for the grouping and be responsible for achieving their agency grouping savings targets. Through this PMO structure, the Government will be positioned to effectively manage and implement the 2020 Fiscal Plan. As such:

- Designated agency heads should lead the Agency PMOs and report directly to the OCFO
- Agency PMOs should undertake the required work to implement initiatives
- The daily activities of PMOs should be managed and undertaken by staff knowledgeable in the relevant subject matter areas, and assigned members meet regularly with PMO leadership to report on progress and facilitate necessary decision-making
- Agency PMOs shall be responsible for assembling a taskforce to: complete validation and definition of full scope of projects and priorities; finalize reporting tools and tracking responsibilities; and perform ongoing weekly tracking and reporting.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

The PMOs should ensure continued implementation progress through robust tracking and reporting tools that foster growth in transparency and ownership, including:

- **Project charters** that establish the goals and structures of measures, identify risks and obstacles, and establish metrics and KPIs

- **Implementation plans** with detailed layouts of each activity required for accomplishing sub-measures, risks / mitigants for each activity, clear leaders and owners for each activity, and metrics and KPIs. These should include a "live" calendar of updates and status of each measure. If an activity goes behind schedule, the workplan will reflect that the activity is still in progress.

- **Implementation dashboard / tracker** that provides a single snapshot of the entire transformation plan; and allows management to know the status of each initiative in a distinct status: Complete; In Progress; Delays; Major Issues. This tracker will allow the Oversight Board to monitor progress and ensure enforcement of measures and reforms.

- **Sub-measure dashboards** that provide "zoomed in" views of a specific sub-measure, display progress with details / commentary on project status, include agreed upon milestones / dates to track progress, and provide mitigation plans

- **Implementation monthly reports** that provide a more detailed perspective on progress, including several key reporting elements: a) headcount by regular and transitory with more details in specific agency cases, b) budget to actuals by cost category and concept, c) milestones progress, d) KPIs/leading indicators, e) achieved savings to date. These reports provide important codification of progress as well as context for monthly meetings where agencies, OCFO and Oversight Board representatives can hold meaningful discussions on progress, items at risk and ongoing mitigating activities

Plan Adjustment (Chapter 21)

On February 28, 2020, the Oversight Board filed an amended Plan of Adjustment for the Commonwealth, ERS, and PBA that proposed a comprehensive settlement between the Commonwealth and its creditors. This represented a significant advance in the ongoing efforts of Puerto Rico to exit bankruptcy, regain access to the capital markets, and begin the process of achieving a true economic recovery. In total, the Plan of Adjustment sought to achieve a nearly 70% reduction in the Commonwealth's total liabilities, a reduction in annual debt service to sustainable and affordable levels, and a substantial and reliable restoration of pensions. This plan followed extensive negotiations between the Oversight Board, Government, and various stakeholder groups, and sought to return the Commonwealth to a sustainable fiscal position, provide meaningful recoveries to creditors, and allow for the continued operation of Government services.

In light of the COVID-19 pandemic, the Oversight Board announced on March 21, 2020 that it would be seeking a motion to adjourn court proceedings on the Plan of Adjustment until further notice. Such action was taken so as to allow for the Government and Oversight Board to prioritize the health and safety of the people of Puerto Rico during this challenging time, and to better understand the economic and fiscal impact of the pandemic. The Oversight Board will continue to work collaboratively with the Government to find reasonable and meaningful financial and policy solutions that ensure the safety and well-being of the Island, while also still preserving prudent and sound fiscal policy.

continue

NOTE U – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Despite the adjournment in court proceedings, the Oversight Board remains committed to facilitating Puerto Rico's emergence from bankruptcy, while also recognizing the new realities facing the Island. It is a fact that certain Plan of Adjustment provisions, if enacted, would impact the primary annual surplus/deficit of the Commonwealth. The 2020 Fiscal Plan therefore incorporates all such provisions on the terms published in the February 28, 2020 Plan of Adjustment (as adjusted for the delay in any confirmation timing).

NOTE V – RELATED-PARTY TRANSACTIONS AND OTHER INTERGOVERNMENTAL TRANSACTIONS

During the year ended June 30, 2018, the Puerto Rico Department of Housing (PRDH) entered into the following related party or intergovernmental transactions:

1. Puerto Rico Electric Power Authority (PREPA) – The Electric power company is a government-owned corporation of Puerto Rico responsible for electricity generation, power transmission, and power distribution in Puerto Rico. During the year the PRDH incurred electricity expenditures amounting $1,131,200.

2. Puerto Rico Aqueducts and Sewers Authority (PRASA) – Water company and government-owned corporation of Puerto Rico responsible for water quality, water management, and water supply in Puerto Rico. The PRDH incurred in expenditures regarding the services provided by the PRASA amounting $58,814.

3. The Puerto Rico Public Housing Administration (PRPHA) – The PRDH received from the PRPHA rent income and indirect costs reimbursements in the amounts of $1,500,000 and $4,500,000, respectively, for the space used by the PRPHA on the PRDH's main building and other related expenses. This income is used to pay half of the principal and interest expense on a Loans Payable related to the acquisition of the PRDH main building and to cover other administrative expenses. The amounts receivable and payable between the PRPHA and the PRDH, as of June 30, 2019 are presented in the financial statements as follows:

Financial Statements Accounts	Statement of Net Position	Balance Sheet – Governmental Funds
Other Accounts Receivable	$6,091,242	$6,091,242
Account Payable Long Term	$10,077,309	$0

   Also, an account payable long term is register as part of the Developer advance made by PRPHA on behalf of the PRDH as part of the mixed financing agreements. This amount as of June 30, 2019 is $33,900,256, The account payable long term to the PRPHA relates to the mixed finance projects and other housing programs. This account is payable from the resources that are expected from the Note Receivable from Related Entity and Developer.

4. Puerto Rico Department of the Treasury (PRDT) – As of June 30, 2019 the PRDH had an amount due to the PRDT of $813,962, related to expenditures incurred for the Community Development Block Grant Program and the Community Development Block Grant – Disaster Recovery Program. Such amounts will be repaid as soon as federal funds are received from FEMA.

continue

NOTE V – RELATED-PARTY TRANSACTIONS AND OTHER INTERGOVERNMENTAL TRANSACTIONS – continuation

5. Special Communities Perpetual Trust (the Trust) - The PRDH grants leases to the participants of the housing program of the Special Communities Perpetual Trust (the Trust), a component unit of the Commonwealth of Puerto Rico, when circumstances cause a delay in the process of granting the mortgage loans. Once the circumstances preventing the granting of the mortgage are resolved, the lease granted by the PRDH is terminated and a mortgage loan is granted by the Trust. The revenue generated by the leases is passed on from the PRDH to the Trust. The PRDH collects lease and mortgage payments from the Trust's program participants and charges the Trust a fee of 15% of the collections processed. These fees amounted to approximately $75,519 for the year ended on June 30, 2019.

   The Trust may contribute funds to the PRDH for the expropriations of land, housing and buildings. Pursuant to the Trust's programs and objectives, these properties have been purchased in order to either, develop the infrastructure of a special community and later transfer such developments to the community or to acquire housing for relocated residents, who would in turn eventually enter into a rental or mortgage agreement with the Trust, through the PRDH. These properties have been purchased in the names of PRDH (or the Department of Transportation and Public Works) because the Trust does not have the power and authority to purchase such assets and register them on the Trust's name. The amounts contributed by the Trust are recorded as program expenditure in the year the disbursements are made. During the year ended June 30, 2019 no contributions were made by the Trust.

NOTE W – DISASTER RECOVERY EFFORTS - STEP PROGRAM

Following the widespread devastation of Hurricanes Irma and María on September 6, 2017 and September 20, 2017, respectively, the U.S. and Federal agencies responded with one the largest and most complex disaster recovery efforts in U.S. history. On September 21, 2017 the U.S. President issued a *Major Disaster Declaration for Puerto Rico*, ordering federal assistance to supplement Puerto Rico's recovery efforts and authorizing federal funding for emergency works in all seventy-eight (78) Municipalities of Puerto Rico.

As part of the recovery efforts, the PRDH started the implementation of a *Sheltering and Temporary Essential Power Program* (hereinafter "STEP"), locally known as *Tu Hogar Renace*. Under STEP, the PRDH performed minor emergency repairs in single-family owner-occupied residences, as to provide citizens displaced from their homes with the option of returning and sheltering in-place in a safe, sanitary and secure matter. The program officially began on January 10, 2018, while repair work began on January 22, 2018. The Federal Emergency Management Agency (FEMA), an agency ascribed to the U.S. Department of Homeland Security, set the budget for the STEP program. For the Project Manager, a budget of $ 180 million (75,000 households @ $2,400 per household) was established for the administration and management of the Program. In addition, a budget of $1.5 billion was established for repairs (75,000 homes @ $20,000 per household). In total, the STEP program established $1,680 million in federal funds approved by FEMA at no cost sharing until May 18, 2018 (date that was later extended until September 15, 2018).

As of June 30, 2019 the STEP Program had 6,479 requests for information/clarification, 7,302 complaints and 4,981 warranty claims. The Oversight Management (OM) continues monitoring the STEP Program's Status Inquiries, Complaints and Warranty Claims, to verify the completeness and accuracy for the preliminary closing packages.

continue

NOTE X – SUBSEQUENT EVENTS

Management has evaluated subsequent events through April 14, 2021, the date the financial statements were available to be issued.

Block Grant Program for Community Development for Disaster Recovery of Puerto Rico

The Block Grant Program for Community Development for Disaster Recovery of Puerto Rico (CDBG-DR, for its acronym) is made to ensure decent and affordable housing opportunities, provision of services, assistance to the most vulnerable in our communities, the expansion and conservation of jobs. The funds from this Program come from the Disaster Recovery Program for community development of the United States Department of Housing and Urban Development (HUD) to provide support for disaster recovery activities, including reconstruction and housing development.

The PRDH has been designated as the entity responsible for administering these funds that will help in the recovery from the disasters caused by Hurricanes Irma and María of 2017; This includes long-term recovery, housing restoration, economic infrastructure and revitalization. As of June 30, 2018, the PRDH had hired consultants to prepare the program's action plan. Said plan was submitted on July 29, 2018.

The Action Plan for the use of funds from the CDBG-DR program was completed and approved by HUD, with some amendments. The Action Plan defines how the urgent humanitarian needs of the island's residents will be met while developing and implementing a transformative recovery. The Action Plan corresponding to the first $1,500 million appropriation was approved by the United States Department of Housing and Urban Development (HUD) on July 29, 2018. This document includes an analysis of the first calculation of damages and informs about the preliminary design of the 19 initial programs that will address the urgent needs of Housing, Planning, Economic Recovery and Infrastructure. On August 14, 2018, the Federal Notice for the second allocation of $8,220 million was published. This notification establishes the conditions of how these funds may be used. Under this premise, the draft of the Substantial Amendment to the approved Action Plan was developed, which was published on September 21, 2018 for public comment. The Substantial Amendment to the Action Plan maintains the initial 19 programs established in the action plan approved by HUD, with some changes to the programs and their budgets. In addition, eight additional programs are added to respond to the needs of citizens. On February 28, 2019, HUD approves the Substantial Amendment to the Action Plan. The PRDH will continue with the implementation of the plan as approved.

Program for Community Development Block Grant

Per Law no. 162 of July 27, 2018, the PRDH was designated to receive and administer the "Community Development Block Grant" (CDBG). These funds were administered by the Office for Socioeconomic and Community Development (ODESEC). As part of this Act, personnel with regular career status of the former Office of the Commissioner of Municipal Affairs (OCAM) who were transferred to the Office for Socioeconomic and Community Development of Puerto Rico (ODSEC) by virtue of Law 10-2017.

Under the Federal Law, of the total allocation of the CDBG, the State may separate a State Administration Fund to cover its own administrative expenses and provide technical assistance to the municipalities. In accordance with the federal regulations of the "Code of Federal Regulations" (24 CFR 570-483 (d)), after separating the state administration fund and the municipal technical assistance fund, the PRDH may separate a party of funds to be allocated to emergency activities. Once the PRDH deduces these items, the available funds will be distributed equally among all the municipalities classified as "non-entitlement", except for the municipalities of Vieques and Culebra, which will be awarded a fifteen percent (15%) additional to that granted to the other municipalities. The funds may be used by the municipalities for the execution of the eligible activities as described in the State Action Plan of the corresponding Program Year.

continue

NOTE X – SUBSEQUENT EVENTS – continuation

Worldwide Pandemic of Coronavirus (COVID-19)

This event that has impact the PRDH is the Coronavirus Pandemic, known as COVID-19, which forced a worldwide outbreak causing, in this case, a government and business disruption through mandated and voluntary closings of multiple companies and governmental entities on the island. While the disruption is expected to be temporary, there is a considerable uncertainty around the duration of the closings.

Effective as of August 6, 2020, HUD provided to the PRDH approximately $25.6 million in supplemental Community Development Block Grant (CDBG) funds made available to prevent, prepare for, and respond to coronavirus (CDBG-CV funds) and annual formula CDBG grants awarded in fiscal years 2019 and 2020. The PRDH may use CDBG-CV funds as reimbursement for previously incurred costs, provided that those costs are allowable and consistent with the CARES Act's purposes. The period of performance for this funding assistance shall be six years.

At least 70 percent of every grant must be expended for activities that benefit low-and-moderate-income persons by providing housing, a permanent job, a public service, or access to new or significantly improved infrastructure. The remaining 30 percent may be used to eliminate slum or blighted conditions, or to address an urgent need for which the grantee certifies it has no other funding. Eligible activities include:

- Public service activities
- Housing-related activities
- Public improvements and facilities
- Activities to acquire real property
- Economic development activities
- General administrative and planning activities

Activities must benefit residents within the jurisdiction of the grantee or as permitted by the CARES Act.

Distribution of Federal funds Previously Deposited at GDB

On June 24, 2020, pursuant to Section 1.7 of the Deed of Constitution of Trust Number Fifty-Six – GDB Public Entity Trust, the GDB, as Trustee of the GDB Public Entity Trust, certified that the PRDH has complied with the requirements set forth in Section 1.7 for the distribution of Federal funds previously deposited at GDB and was authorized to submit a budgetary disbursement request in the amount of $9,801,281 through the Office of Management and Budget.

END OF NOTES

REQUIRED SUPPLEMENTARY INFORMATION

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SCHEDULE OF REVENUES AND EXPENDITURES – BUDGET AND ACTUAL – GENERAL FUND – NON-GAAP BUDGETARY BASIS
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	Budget Amounts		Actual Amounts	
	Original	Final	Budgetary Basis	Variance
Revenues:				
Appropriations from Commonwealth	$ 10,524,000	$ 11,872,180	$ 11,872,180	$ -
Expenditures:				
General and Administrative	10,524,000	11,872,180	10,261,371	1,610,809
Excess of Revenues Over Expenditures	$ -	$ -	$ 1,610,809	$ 1,610,809

The accompanying Notes to Schedule of Revenues and Expenditures – Budget and Actual – General Fund are an integral part of this schedule.

NOTE A – BUDGETS AND BUDGETARY ACCOUNTING

The Department of Housing of the Commonwealth of Puerto Rico ("PRDH") follows these procedures in establishing the budgetary data reflected in the financial statements:

1. Formal budgetary integration is employed as a management control device during the year for the General Fund. The Department of the Treasury and the Office of Management and Budget of Puerto Rico have the responsibility to ensure that budgetary spending control is maintained in the PRDH. Budgetary control is exercised through the Puerto Rico Integrated Financial Accounting System ("PRIFAS").

2. On or before November 15, the Secretary submits to the Office of Management and Budget of Puerto Rico a proposed operating budget for review and approval. OMB will submit the revised budget to the Legislature of the Commonwealth of Puerto Rico for final approval to be effective for the fiscal year commencing the following July 1. The operating budget includes proposed expenditures and the means for financing them.

3. The budget is legally enacted through passage of a law.

4. Unused appropriations for the annual budgeted funds lapse at the end of the year.

5. The budget is prepared on the budgetary basis of accounting. The actual results of operations presented in the *Budgetary Comparison Schedule – Budget and Actual – General Fund* are in conformity with the budgetary accounting for a better comparison with the budget information. See Note A to the basic financial statements.

6. Explanation of Differences Between Budgetary Inflows and Outflows Revenues and Expenditures:

Excess of Revenues Over Expenditures	$	1,610,809
Timing Differences:		
Current Year Expenditures Against Prior Year Encumbrances		(226,554)
Net Change In Fund Balances - U.S. GAAP Basis	$	1,384,255

END OF NOTES

	2018	2017	2016	2015
Proportion of the Net Pension Liability	0.19528%	0.22948%	0.22826%	0.22813%
Proportionate Share of the Net Pension Liability	$ 66,822,303	$ 86,510,924	$ 76,095,704	$ 68,755,048
Covered Employee Payroll	$ 6,530,651	$ 7,674,671	$ 7,576,556	$ 7,959,592
Proportionate Share of the Net Pension Liability as a Percentage of Covered Employee Payroll	1023.31%	1127.23%	1004.36%	863.80%
Plan Fiduciary Net Position	$ (4,118,286)	$ (2,904,947)	$ (1,525,391)	$ 183,023
Plan Fiduciary Net Position (Deficit) as a Percentage of Total Pension Liability	-6.57%	-3.47%	-2.05%	0.27%

	2018	2017	2016	2015
Contractually Required Contribution (Actuarialy Determined)	$ 1,540,818	$ 1,847,863	$ 2,253,215	$ 1,389,416
Contributions in Relation to the Actuarialy Required Contributions	1,391,136	1,534,219	1,453,161	1,389,416
Contribution Deficiency (Excess)	$ 149,682	$ 313,644	$ 800,054	$ -
Covered Employee Payroll	$ 6,530,651	$ 7,674,671	$ 7,576,556	$ 7,959,592
Contributions as a Percentage of Covered Employee Payroll	21.30%	19.99%	19.18%	17.46%

1. The amounts presented in the Schedules were prepared in accordance with U.S. generally accepted accounting principles. The numbers were derived from a report issued by KPMG dated November 2, 2018. The full report is available by the Employees' Retirement System. Such preparation requires management of ERS to make a number of estimates and assumptions relating to the reported amounts. Due to the inherent nature of these estimates, actual results could differ from those estimates.

2. This information is intended to help users assess the PRDH's pension plan's status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employers.

3. Fiscal year 2015 was the first year that the new requirements of GASB 68 were implemented at the PRDH. This schedule is required to illustrate 10-years of information. However, until a 10-year trend has been completed, information is presented only for the years for which the required supplementary information is available.

4. Methods and Assumptions Used in Calculation of the ERS's Annual Required Contributions:

   Unless otherwise noted above, the following actuarial methods and assumptions were used to determine contribution rates reported in the Pension Benefit Schedule of the Employers' Contributions:

Asset Value Method	Market value of assets
Inflation Rate	Not applicable
Investment Rate of Return	Not applicable
Municipal Bond Rate	3.58% per annum (Bond Buyer General Obligation 20-Bond Municipal Bond Index)
Discount rate	3.58% per annum
Projected Salary Increases	Not applicable

5. Mortality:

   Pre-retirement Mortality

   - For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis.
   - For members covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis.
   - As generational tables, they reflect mortality improvements both before and after the measurement date.
   - 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.

continue

Post-retirement Healthy Mortality:

- Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of 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 the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA.

- These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis, which reflects mortality improvements both before and after the measurement date.

Post-retirement Disabled Mortality:

- Rates which vary by gender are assumed for disabled retirees based on a study of 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 CIP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females.

- These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

6. The information presented relates solely to the PRDH and not Employee's Retirement System of the Government of the Commonwealth of Puerto Rico as a whole.

END OF NOTES

SUPPLEMENTARY INFORMATION REQUIRED BY
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

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Line Item No. Assets		Value
	Current Assets - Cash:	
111	Cash - Unrestricted	$ 4,649,784
113	Cash - Other Restricted	781,174
115	Cash - Restricted For Payments of Current Liabilities	214,574
100	**Total Cash**	**5,645,532**
	Receivable:	
124	Account Receivable - Other Government	416,913
125	Account Receivable - Miscellaneous	9,879
128	Fraud Recovery	536,491
120	**Total Receivable, Net of Allowances for Doubtful Accounts**	**963,283**
131	Investments - Unrestricted	1,286,612
132	Investments - Restricted	-
150	**Total Current Assets**	**7,895,427**
144	Due from Other Funds	-
200	Deferred Outflow of Resources	-
290	**Total Assets and Deferred Outflows of Resources**	**$ 7,895,427**
Liabilities and Equity		
	Current Liabilities:	
331	Account Payable - HUD PHA Program	$ 32,582
345	Other Current Liabilities	181,991
310	**Total Current Liabilities**	214,573
	Non-current Liabilities:	
353	Non-Current Liabilities - Other	206,384
350	**Total Non-Current Liabilities**	206,384
300	**Total Liabilities**	**420,957**
400	Deferred Inflow of Resources	-
	Equity	
511.4	Restricted Net Position	574,792
512.4	Unrestricted Net position	6,899,678
513	**Total Equity - Net Assets / Position**	**7,474,470**
600	**Total Liabilities and Equity/ Net Position**	**$ 7,895,427**

The accompanying Notes to Financial Data Schedule are an integral part of this Supplementary Information.

Line Item No. Revenue		Value
70600	HUD PHA Operating Grant	$ 62,295,272
71100	Investment Income - Unrestricted	40,826
71400	Fraud Recovery	352,104
71500	Other Revenue	495,993
70000	**Total Revenue**	**63,184,195**
Expenses	**Administrative:**	
91100	Administrative Salaries	2,118,249
91200	Auditing Fees	45,468
91500	Employee Benefit Contribution - Administrative	506,080
91600	Office Expenses	1,714,792
91800	Travel	71,686
91000	**Total Operating - Administrative**	**4,456,275**
	Tenant Services	
92400	Tenant Services - Other	946,778
92500	**Total Tenants Services**	**946,778**
	Utilities	
93100	Water	-
93200	Electricity	-
93000	**Total Utilities**	**-**
95200	Protective Services - Other Contract Cost	352,210
95000	**Total Protective Services**	**352,210**
96130	Workmen's Compensation	40,941
96100	**Total Insurance Premiums**	**40,941**

continue

Line Item No. Expenses		Value
	General Expenses	
96200	Other General Expenses	470,815
96000	**Total Other General Expenses**	**470,815**
96900	**Total Operating Expenses**	**6,267,019**
97000	**Excess of Operating Revenue Over Operating Expenses**	**56,917,176**
97300	Housing Assitance Payment	55,264,227
97350	HPA Portability - In	52,078
90000	**Total Expenses**	**61,583,324**
10000	**Excess (Deficiency) of Total Revenue over (Under) Total Expenses**	**1,600,871**
	Memo Account Information:	
*11130	Beginning Equity	5,873,599
*11170	Administrative Fee Equity	$ 6,899,678
*11180	Housing Assitance Payment Equity	$ 574,792
*11190	Unit Month Available	116,403
*11210	Number of Units Month Leased	111,537

The accompanying Notes to Financial Data Schedule are an integral part of this Supplementary Information.

1. GENERAL

The accompanying Financial Data Schedules presents the expenditures of Section 8 Housing Choice Vouchers Program federal award, for the fiscal year ended June 30, 2019, of the Puerto Rico Department of Housing.

2. ACCOUNTING BASIS

The schedule was prepared on accrual basis of accounting except for fraud recoveries plans that are accounted using the Section 8 Housing Choice Voucher following the statutory basis of accounting required by the US Department of Housing and Urban Development.

END OF NOTES

PART II

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND REPORTS REQUIRED BY
GOVERNMENT AUDITING STANDARDS AND UNIFORM GUIDANCE

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Federal Grantor/Pass-Through Grantor/Program or Cluster Title	*Federal CFDA Number*	*Pass-Through Entity Identifying Number*	*Passed Through to Subrecipients*	*Total Federal Expenditures*
U.S. Department of Agriculture Program:				
Pass-Through the Puerto Rico Department of Education:				
Child and Adult Care Food Program	10.558		$ -	$ 21,480
Total U.S. Department of Agriculture Program			**-**	**21,480**
U.S. Department of Housing and Urban Development Programs:				
Community Development Block Grant / Entitlements Grant	14.218		13,817,098	18,136,015
Continuum of Care Program	14.267		-	1,083,820
Section 8 Housing Choice Vouchers Program	14.871		-	61,583,324
Total U.S. Department of Housing and Urban Development Programs			**13,817,098**	**80,803,159**
U.S. Department of Homeland Security:				
Pass-Through the Puerto Rico Governor Authoritative Representative Office:				
Sheltering and Temporary Essential Power	97.U01		-	1,004,654,026
Total U.S. Department of Homeland Security			**-**	**1,004,654,026**
Total Expenditures of Federal Awards			**$ 13,817,098**	**$ 1,085,478,665**

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral part of this Schedule.

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal award activities of the Department of Housing of the Commonwealth of Puerto Rico (PRDH) under programs of the Federal government for the fiscal year ended June 30, 2019. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the PRDH, it is not intended to and does not present the financial position, changes in net position, or cash flows of the PRDH.

Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. PRDH reporting entity is defined in Note (1) (A) to the basic financial statements. All federal financial awards received directly from federal agency as well as federal financial awards passed-through other government agencies, if any, are included on the Schedule.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following, as applicable, the cost principles in Office of Management and Budget Circular A-87, State and Local Governments, or the cost principles contained in Subpart E of Title 2 U.S. Code of Federal Regulation Part 200, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

B. Negative amounts, if any, shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

C. Pass-through entity identifying numbers are presented where available and applicable.

D. PRDH has elected not to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

3. SCHEDULE NOT IN AGREEMENT WITH OTHER FEDERAL AWARD REPORTS

The information included in the Schedule may not fully agree with other federal award reports submitted directly to federal granting agencies.

4. FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

Sheltering and Temporary Essential Power

For the Sheltering and Temporary Essential Power (STEP) program the CFDA number was requested to the Puerto Rico Office of Disaster and Emergency Administration. However, the information was not received. The grant is restricted for providing minor emergency repairs to single-family owner-occupied residences caused by hurricanes Irma and Maria in September 2017. Refer to Note V to the financial statements for a more detail description of this program.

Community Development Block Grants/Entitlement Grants

This Community Development Block Grants/Entitlement Grants (CDBG) program provides annual grants to municipalities to develop viable urban communities by providing decent housing and a suitable living environment, and by expanding economic opportunities, principally for low- and moderate-income persons.

continue

4. FEDERAL CFDA NUMBER - continuation

Community Development Block Grants/Entitlement Grants

The CDBG program includes funds for the Community Development Block Grants/Entitlement Grants – Disaster Recovery Program or CDBG-DR program which provides funds to rebuild areas affected by Presidentially declared disasters and provide crucial seed money to start the recovery process.

Expenditures under this program and amounts pass-through to subrecipients for the year ended June 30, 2019 was as follows:

	Federal CFDA Number	*Pass-Through Entity Identifying Number*	*Passed Through to Subrecipients*	*Total Federal Expenditures*
Community Development Block Grants / Entitlement Grants	14.218			
FY 2009 Grant		B09DC7201	$ 101,687	$ 103,351
FY 2010 Grant		B10DC7201	102,369	102,369
FY 2011 Grant		B11DC7201	176,884	176,884
FY 2012 Grant		B12DC7201	312,783	312,783
FY 2013 Grant		B13DC7201	151,909	151,909
FY 2014 Grant		B14DC7201	776,861	776,861
FY 2015 Grant		B15DC7201	629,032	629,032
FY 2016 Grant		B16DC7201	1,971,829	1,971,829
FY 2017 Grant		B17DC7201	6,131,141	6,131,141
FY 2018 Grant		B18DC7201	603,971	1,077,497
Sub Total Community Development Block Grants / Entitlement Grants			10,958,466	11,433,656
CDBG - Disaster Recovery Program		B17DM7201	2,858,632	6,702,359
Total Community Development Block Grants / Entitlement Grants Program			**$ 13,817,098**	**$ 18,136,015**

5. RELATIONSHIP TO STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS

Expenditures of federal awards are reported in PRDH's *Statement of Revenues, Expenditures and Changes in Fund Balance – Governmental Fund* in the Section 8 Housing Choice Vouchers Program, FEMA Recovery Fund, Community Development Block Grant Fund, Community Development Block Grant – Disaster Recovery Fund, Self-Contribution Fund. Sales and Acquisition Fund, and Other Governmental Funds columns.

6. LATE ISSUANCE OF SINGLE AUDIT REPORTING PACKAGE

As described in finding 2019-001 in Section III of the Schedule of Findings and Questioned Costs, the **PRDH** was unable submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2019 during the required period.

The main reason for the delay was the Coronavirus Pandemic, known as COVID-19, which forced a worldwide outbreak causing, a government and business disruption through mandated and voluntary closings of multiple companies and governmental entities on the island. As further explain in Note X to the financial statements, the Pandemic delayed the operations of the government and the audit procedures. **PRDH** develop a plan to continue providing its services to the community and comply with the federal grants' requirements.

END OF NOTES

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CPA DIAZ-MARTINEZ, PSC
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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Honorable Secretary of the
Department of Housing of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

We have audited, in accordance with the 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, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Department of Housing of the Commonwealth of Puerto Rico** (**PRDH**), as of and for the fiscal year ended June 30, 2019, and the related notes to basic financial statements, which collectively comprise **PRDH**'s basic financial statements, and have issued our report thereon dated April 14, 2021. Our report was qualified because we were unable to obtain sufficient appropriate audit evidence about the proportional share used to determine the deferred outflows/inflows of resources, net pension liability, pension expenses of the governmental activities and note of pension plan the PRGERS has not issued, or made available information in order to properly adjust or disclose any deferred outflows/inflows of resources, or net other postemployment benefits liability, applicable to the **PRDH**.

Going Concern

PRDH is part of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statements includes an emphasis-of-matter paragraph describing conditions, discussed in Note T to the basic financial statements, that raised substantial doubt about the Commonwealth of Puerto Rico's ability to continue as a going concern.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered **PRDH**'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of **PRDH**'s internal control. Accordingly, we do not express an opinion on the effectiveness of **PRDH**'s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of **PRDH**'s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weakness or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weakness. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of **PRDH**'s internal control or on compliance. This report is an integral part of an audit reformed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2022

Caguas, Puerto Rico
April 14, 2021

Stamp No. E438143 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

Honorable Secretary of the
Department of Housing of the
Commonwealth of Puerto Rico
San Juan, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited **Department of Housing of the Commonwealth of Puerto Rico** (**PRDH**)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of **PRDH**'s major federal programs for the fiscal year ended June 30, 2019. **PRDH**'s major federal programs are identified in the Summary of Auditors' Result Section of the accompanying Schedule of Findings and Questioned Costs.

Going Concern

PRDH is part of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statements includes an emphasis-of-matter paragraph describing conditions, discussed in Note T to the basic financial statements, that raised substantial doubt about the Commonwealth of Puerto Rico's ability to continue as a going concern.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of **PRDH**'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about **PRDH**'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of **PRDH**'s compliance.

Basis for Qualified Opinion on Major Federal Programs

As described in the accompanying Schedule of Findings and Questioned Costs, **PRDH** did not comply with requirement regarding all Federal Programs as described in Finding Number 2019-001 for Reporting. Compliance with such requirement is necessary, in our opinion, for the **PRDH** to comply with the requirements applicable to those programs.

Qualified Opinion on Each Major Federal Program

In our opinion, except for the noncompliance described in the *"Basis for Qualified Opinion on Major Federal Programs"* paragraph, **PRDH** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the fiscal year ended June 30, 2019.

Other Matters

PRDH's response to the noncompliance findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. **PRDH**'s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

Management of **PRDH** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered **PRDH**'s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **PRDH**'s internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as item 2019-001 to be material weakness.

PRDH's response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. **PRDH**'s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2022

Caguas, Puerto Rico
April 14, 2021

Stamp No. E438144 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

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PART III

FINDINGS AND QUESTIONED COSTS

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SECTION I – SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued:

☒ Unmodified Opinions
- Governmental Fund Financial Statements

☒ Qualified Opinion
- Government-wide Financial Statements

☐ Adverse Opinion ☐ Disclaimer Opinion

Internal control over financial reporting:

- Material weakness (es) identified? ☐ Yes ☒ No
- Significant deficiency (ies) identified? ☐ Yes ☒ None Reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

Federal Awards

Internal control over Major Federal Programs:

- Material weakness (es) identified? ☒ Yes ☐ No
- Significant deficiency (ies) identified? ☐ Yes ☒ None Reported

Type of auditors' report issued on compliance for Major Federal Programs:

☐ Unmodified Opinion

Modified:
☒ Qualified Opinion
All Federal Programs
☐ Adverse Opinion
☐ Disclaimer Opinion

Any audit finding disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? ☒ Yes ☐ No

Identification of Major Federal Programs:

CFDA NUMBER	NAME OF FEDERAL PROGRAM OR CLUSTER
14.218	Community Development Block Grant/Entitlement Grant
97.U01	Sheltering and Temporary Essential Power (STEP)

Dollar threshold used to distinguish between Type A and Type B Programs: $3,256,436

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

continue

SECTION II – FINANCIAL STATEMENT FINDINGS

Our audit disclosed no findings that are required to be reported herein under the *Government Auditing Standards*.

continue

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER	**2019-001**
FEDERAL PROGRAM	**ALL PROGRAMS**
AWARD NUMBERS	**ALL**
COMPLIANCE REQUIREMENT	**REPORTING**
TYPE OF FINDING	**MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS**
CRITERIA OR SPECIFIC REQUIREMENT	2 CFR §200.512 Report Submission, (a) (1) The audit must be completed and the Data Collection Form described in paragraph (b) of this section and reporting package described in paragraph (c) of this section must be submitted within the earlier of 30 calendar days after receipt of the auditor's report(s), or nine months after the end of the audit period. If the due date falls on a Saturday, Sunday, or Federal holiday, the reporting package is due the next business day.
CONDITION	The **PRDH** did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2019 during the required period.
QUESTIONED COSTS	None
CONTEXT	The **PRHD** was unable to provide timely the financial statements and related supporting documentation in order to apply required audit procedures.
EFFECT	The **PRHD** did not comply with the submission date required for the Data Collection Form and Reporting Package, this could affect the continuance and new approvals of federal funds. In addition, for the next two (2) fiscal years the **PRHD** cannot be considered by the auditor as a low risk auditee.
CAUSE	**PRDH** did not have an effective accounting system and procedures to assure that the required financial statements and supporting documentation was made available for audit purposes within the required period established to comply with the federal regulations.
RECOMMENDATION	We recommend the **PRHD** to maintain adequate accounting records related to the non-federal and Federal funds in order to properly prepared the financial statements accurate and in a timely manner. In addition, the **PRHD** need to implement adequate internal controls procedures in order to assure that the supporting documentation is available on a timely manner.
VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTIONS	The delay in the issuance of the Single Audit Report package was due to two main reasons. First, certain important financial information related to the pension liability was not available in a timely manner. Such information is provided by another State Agency of the Government of Puerto Rico. The Central Government of the Commonwealth of Puerto Rico requested to hold the financial statements until such audited financial information was available. Even though we waited for over a year the information was never provided. For this deficiency we received a qualified opinion on the financial statements. Second, the COVID-19 pandemic delayed the completion of the audit and the preparation of the financial statements. To correct this condition, PRDH decided that for the next financial statements (and the Single Audit Report package) PRDH will issued the reports even if the pension financial information is not delivered on time to be included in our financial statements.

continue

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

FINDING REFERENCE NUMBER **2019-001** – continuation

IMPLEMENTATION DATE Single Audit for fiscal year 2020-2021, due on March 31, 2022

RESPONSIBLE PERSON Mr. Juan R. Rivera-Carrillo, Assistance Secretary for Finance and Administration

END OF SCHEDULE

(1) Audit Findings that have been Fully Corrected:

FISCAL YEAR 2018

Findings Related to the Federal Programs:

Finding Number	**2018-001**	**Reporting** The Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2018 not submitted during the required period.
CFDA Numbers	All	
Questioned Cost	None	
Auditee Comments	By letter dated January 22, 2020, Oversight Agency closed this finding.	

FISCAL YEAR 2017

Finding Number	**2017-002**	**Special Tests and Provisions** Deficiencies noted during the HQS Enforcement of properties.
CFDA Numbers	14.871	
Questioned Cost	None	
Auditee Comments	By letter dated January 22, 2020, Oversight Agency closed this finding.	

(2) Audit Findings not Corrected or Partially Corrected:

FISCAL YEAR 2017

Findings Related to the Federal Programs:

Finding Number	**2017-001**	**Reporting** Difference in the HAP payments expenditures reported against the amount reported in REAC and in the financial statements.
CFDA Numbers	14.871	
Questioned Cost	None	
Auditee Comments	By letter dated June 12, 2019, Oversight Agency requested the PRDH copies of the amended reports to the FO for review. By letter dated January 22, 2020, Oversight Agency maintained open this finding.	

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

END OF SCHEDULE

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GOVERNMENT OF PUERTO RICO
Department of Housing

Single Audit FY 2018-2019
Corrective Action Plan

FINDING NUMBER	2019-001
AUDITOR'S DESCRIPTION	MATERIAL NONCOMPLIANCE AND MATERIAL WAEKNESS
CONDITION	The **PRDH** did not submit the Data Collection Form and Reporting Package to the Federal Audit Clearinghouse of fiscal year ending June 30, 2019 during the required period.
AUDITOR'S RECOMMENDATION	We recommend the **PRHD** to maintain adequate accounting records related to the non-federal and federal funds in order to properly prepared the financial statements accurate and in a timely manner. In addition, the **PRHD** need to implement adequate internal controls procedures in order to assure that the supporting documentation is available on a timely manner.
CORRECTIVE ACTION PLAN	The delay in the issuance of the Single Audit Report package was due to two main reasons. First, certain important financial information related to the pension liability was not available in a timely manner. Such information is provided by another State Agency of the Government of Puerto Rico. The Central Government of the Commonwealth of Puerto Rico requested to hold the financial statements until such audited financial information was available. Even though we waited for over a year the information was never provided. For this deficiency we received a qualified opinion on the financial statements. Second, the COVID-19 pandemic delayed the completion of the audit and the preparation of the financial statements. To correct this condition, PRDH decided that for the next financial statements (and the Single Audit Report package) PRDH will issued the reports even if the pension financial information is not delivered on time to be included in our financial statements.
LEAD PERSONS ACCOUNTABLE FOR ACTION ITEM COMPLETION	Juan R. Rivera-Carrillo Assistance Secretary for Finance and Administration

DELIVERABLE	Single Audit Report package
EVIDENCE INCLUDED YES/NO	No
TARGET COMPLETION DATE	Single Audit for fiscal year 2020-21, due on March 31, 2022

Certifying Official: ______________________

Name and Position: Juan R. Rivera-Carrillo, Assistance Secretary for Finance and Administration

Date: April 14, 2021