

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF AGRICULTURE**

**FINANCIAL STATEMENT**

**FOR THE FISCAL YEAR ENDED JUNE 30, 2019**

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



***CPA DIAZ-MARTINEZ, PSC***  
**CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS**

*Member of:*



Governmental Audit Quality Center  
Puerto Rico Society of Certified Public Accountants  
Enrolled in the AICPA Peer Review Program Since 1988

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**PART I**  
**FINANCIAL**

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## INDEPENDENT AUDITOR'S REPORT

To the Honorable Carlos A. Flores Ortega, Secretary  
Department of Agriculture of the  
Commonwealth of Puerto Rico  
San Juan, Puerto Rico

### Report on the Financial Statement

We have audited the accompanying cash basis financial statement of the **Department of Agriculture of the Commonwealth of Puerto Rico (Department)**, which comprise Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Funds for the fiscal year ended June 30, 2019, and the related notes to financial statement.

### *Management's Responsibility for the Financial Statement*

Management is responsible for the preparation and fair presentation of this financial statement in accordance with cash basis of accounting described in Note 2. This includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statement that are free from material misstatement, whether due to fraud or error.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on this financial statement 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 statement is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the **Department's** preparation and fair presentation of the financial statement 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 **Department'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 statement.

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

**INDEPENDENT AUDITOR'S REPORT**  
**To the Honorable Carlos A. Flores Ortega, Secretary**  
**Department of Agriculture of the**  
**Commonwealth of Puerto Rico**  
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***Opinions***

In our opinion, the financial statement referred to previously present fairly, in all material respects, the cash receipts and disbursements of the **Department** governmental funds, and the respective cash basis net changes thereof for the year ended June 30, 2019, in conformity with the basis of accounting described in Note 2.

***Emphasis of Matters***

*Basis of Accounting*

We draw attention to Note 2 of the financial statement that describes the basis of accounting. The financial statement is prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

*Uncertainty about Ability to Continue as a Going Concern – Commonwealth of Puerto Rico (Primary Government)*

As discussed in Note 9 to the financial statement, the **Department** is part of the Commonwealth of Puerto Rico (Commonwealth). 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. The financial statement does not include any adjustments that might result from the outcome of this uncertainty. Our opinions are not modified with respect to this matter.

*Financial Statement Information*

As discussed in Note 1, the financial statement of the **Department** is intended to present the cash receipts, disbursements, and net changes of the governmental funds of only that portion of the financial reporting entity of the Commonwealth of Puerto Rico that is attributable to the transactions of the **Department**. 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. Our opinions are not modified with respect to this matter.

***Other***

*Omitted Component Units*

As discussed in Note 1 to the Financial Statement, the financial statement referred to above include only the primary government of the **Department**, which consists of all funds and offices that comprise the Department's legal entity. This primary government financial statement does not include financial data for the **Department's** legally separate component units, which accounting principles generally accepted in the United States of America require to be reported with the financial data of the **Department**. As a result, the primary government financial statement does not purport to, and do not present fairly the financial position of the **Department** as of June 30, 2019 and the result of operations for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.



**INDEPENDENT AUDITOR'S REPORT**  
**To the Honorable Carlos A. Flores Ortega, Secretary**  
**Department of Agriculture of the**  
**Commonwealth of Puerto Rico**  
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*High-Risk Status*

As discussed in Note 8 to the Financial Statement, since October 29, 2009, the **Department** was notified by the U.S. Environmental Protection Agency (EPA) of its status as high-risk grantee and, as of the date of this report, the **Department** still has a high-risk status since they have not complied with all the special grant conditions.

*Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statement as a whole. The accompanying 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 Awards (Uniform Guidance)*, on pages 73-75, is presented for purposes of additional analysis and is not a required part of the financial statement. The Schedule of Expenditures of Federal Awards is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statement. The information has been subjected to the auditing procedures applied in the audit of the financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statement or to the financial statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects, in relation to the financial statement as a whole.

**Other Reporting Required by Governmental Auditing Standards**

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2020 on our consideration of the **Department'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 the **Department'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  
September 29, 2020

Stamp No. E413105 of the Puerto Rico Society of Certified  
Public Accountants was affixed to the original report.

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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF AGRICULTURE

STATEMENT OF CASH RECEIPTS, DISBURSEMENTS,  
AND NET CHANGES – GOVERNMENTAL FUNDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	State General Fund	State Special Fund	Federal Grants Fund	Total Government Funds
<b>CASH RECEIPTS:</b>				
Appropriations from the Commonwealth of Puerto Rico	\$ 8,045,415	\$ 13,642,000	\$ -	\$ 21,687,415
Federal Grants	-	-	1,259,961	1,259,961
Other Revenues	-	1,894,956	-	1,894,956
<b>Total Cash Receipts</b>	<u>8,045,415</u>	<u>15,536,956</u>	<u>1,259,961</u>	<u>24,842,332</u>
<b>CASH DISBURSEMENTS:</b>				
Farming Development and Special Services	3,138,876	15,725,806	2,210,305	21,074,987
General Administration	-	99,161	-	99,161
Farmers' Incentives – Regional Offices	3,499,059	-	-	3,499,059
General Management	1,681,549	-	-	1,681,549
Planning and Budgeting	236,973	-	-	236,973
<b>Total Cash Disbursements</b>	<u>8,556,457</u>	<u>15,824,967</u>	<u>2,210,305</u>	<u>26,591,729</u>
<b>NET CHANGES</b>	<u>\$ (511,042)</u>	<u>\$ (288,011)</u>	<u>\$ (950,344)</u>	<u>\$ (1,749,397)</u>

The accompanying *Notes to Financial Statement* are an integral part of this Statement.

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## 1. ORGANIZATION AND FINANCIAL REPORTING ENTITY

### A. Organization

The Department of Agriculture of the Commonwealth of Puerto Rico (Department) was originally created under the dispositions of the Jones Act of the United States Congress on March 2, 1917.

The Reorganization Plan Number 4, of July 29, 2010 provided for the following organizational structure for the Department: a central office, seven (7) regional offices and three (3) appointed component units [the Agricultural Enterprises Development Administration (AEDA), the Farm Insurance Corporation of Puerto Rico (FICPR) and the Land Authority of Puerto Rico (LAPR)]. Under the Reorganization Plan, AEDA, FICPR and LAPR have fiscal and operational autonomy. These component units are all legally separate entities and, consistent with GASB Statement No. 14, as amended by GASB Statements No. 39 and 61. These component units are not blended with the Department because they do not provide services entirely, or almost entirely to the Department; their governing board is not substantively the same as that of the Department; the Department does not have any operational responsibilities over them, and they do not have total debt outstanding being repaid entirely or almost entirely with resources of the Department. Since each component unit is required to issue its own separate audited financial statements, the accompanying Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Funds do not include the financial information of AEDA, FICPR and LAPR.

Complete financial statements of these entities can be obtained directly from their administrative offices at:

Agricultural Enterprises Development Administration  
PO Box 9200  
San Juan, PR 00908-9200

Farm Insurance Corporation of Puerto Rico  
PO Box 195661  
San Juan, PR 00919-5661

Land Authority of Puerto Rico  
644 Fernández Juncos Avenue  
San Juan, PR 00907

The Department is subsidized by budgetary appropriations from the Commonwealth of Puerto Rico and by Federal grants received from the United States Department of Agriculture (USDA) and the United States Environmental Protection Agency (EPA).

### B. Financial Reporting Entity

The Department is for financial reporting purposes, part of the Commonwealth of Puerto Rico. Because the Department is for financial reporting purposes, part of the Commonwealth, its financial data is included as part of the Commonwealth of Puerto Rico financial statements. The Department accompanying financial statement is issued solely to comply with the Single Audit Act Amendments of 1996 (P.L. 104-156), when applicable, and for the information and used of the Department's 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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### A. Financial Statement – Measurement Focus and Basis of Accounting

The Department's accompanying financial statement have been prepared in accordance with the cash basis of accounting, which is a special purpose framework other than generally accepted accounting principles in the United States of America (GAAP) as established by the Governmental Accounting Standards Board. The cash basis of accounting involves the recognition, measurement, presentation, and disclosure of cash and cash equivalents and the changes therein resulting from cash receipts (cash inflows) and cash disbursements (cash outflows) transactions or events in the period in which they occurred. Noncash transactions are not recognized in the Statement.

This cash basis of accounting differs from GAAP primarily because revenue (cash receipts) are recognized when received in cash rather than when earned and susceptible to accrual, and expenditures (cash disbursement) are recognized when paid rather than when incurred or subject to accrual. The amounts reported as cash receipts are those received during the fiscal year 2018-2019. No accrual is recognized.

Capital assets resulting from cash transactions are reported as cash disbursements in the acquiring governmental fund upon cash acquisition. No capital assets are recorded in the Department's financial statement. No long-term debt is reported in the Department's financial statement. No accrued compensated absences are reported in the Department's financial statement. Compensated absences resulting from cash transactions are reported as cash disbursements in the governmental funds column upon cash payment.

The Department's funds are under custody and control of the Secretary of the Department of Treasury of the Commonwealth of Puerto Rico and are also accounted for in the Central Government Accounting System. The Department prepares its financial statement for the general operational fund and other funds on the cash basis method. A statement of net assets has not been presented because, as of June 30, 2019, it had not available cash under its custody.

The accounts of the Department are organized on the basis of fund types, which are responsible for the coordination, receipt, and management of funds principally approved by the U.S. Department of Agriculture (USDA) and U.S. Environmental Protection Agency (EPA). These are composed of three funds which are described below. The accounts of the Department are accounted for with a set of accounts which only include cash receipts and cash disbursements. No balance sheet accounts are maintained or reported. The following individual programs account for the governmental resources allocated to them for the purpose of carrying on specified activities in accordance with laws, regulations, and other restrictions:

**State General Fund** – The general fund is the primary operating fund of the Department and is always classified as a major fund. It is used to account for all activities resources except those required to be accounted for separately.

**State Special Fund** – Accounts for resources received from enacted law by the Commonwealth of Puerto Rico to assist in the implementation of various programs.

**Federal Grants Fund** – Accounts for the financial resources related to the Federal Grant Awards administered by the Department.

The major funds are presented in the individual programs to account for the governmental resources allocated to them for the purpose of carrying on specified activities in accordance with laws, regulations, and other restrictions.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### *Notes to Financial Statement*

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

### **B. Stewardship, Compliance, and Accountability**

#### ***Budgetary Information***

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).

The revenues recognized in the General Fund consist of appropriations from the Office of Management and Budget of the Commonwealth of Puerto Rico for recurrent and ordinary functions of the Department. The procedures followed in approving the annual budget is as follows:

- a. Between November and December, the Department submits to the Office of Management and Budget of the Commonwealth of Puerto Rico an operating budget petition for the fiscal year commencing the following July 1.
- b. At the beginning of the ordinary session of the Legislative Assembly of the Commonwealth of Puerto Rico, the governor submits a proposed budget for the fiscal year covering the whole operations of the Commonwealth. This proposal budget includes estimated expenditures and resources of financing them.
- c. The annual budget is legally enacted through the approval of the Legislative Assembly of the Joint resolution of the General Budget. Subsequently to enactment, the Office of Management and Budget of the Commonwealth has the authority to make the necessary adjustments to the budget.

Pursuant to Section 202(a) of PROMESA, the Oversight Board should certify the Consolidated Budget of the Commonwealth of Puerto Rico in accordance with a schedules for a period of six months ending June 30, for the process of developing, submitting, approving, and certifying the Fiscal Year Budget as follow:

- Along with the submission of the Fiscal Plan, Government provides complete inventory listing of all agencies that will be allocated budgets included in the Fiscal Plan, and will detail any consolidation of agencies or new agencies.
- Consistent with PROMESA 202(b), Oversight Board sends Governor and Legislature a forecast of revenues. The Oversight Board sends the Governor and Legislature agency budget targets on a personnel and non-personnel basis and a detailed data request.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- Consistent with PROMESA 202(c)(1), the Governor submits a proposed Fiscal Year Budget based on the forecast of revenues and agency budget targets along with detailed support documentation for any variances. The Boards of Directors of Independently Forecasted Component Units submit proposed budget resolutions based on the forecast revenues and agency budget targets along with detailed support documentation for any variances.
- Pursuant to PROMESA 202(c)(1)(B), the Oversight Board sends the Governor a notice of violation, as needed.
- Pursuant to PROMESA 202(c)(2), the Oversight Board submits a revised compliant Fiscal Year Budget to the Governor and Legislature.
- Pursuant to PROMESA 202(d)(1), the Legislature submits a proposed Fiscal Year Budget to the Oversight Board.
- Pursuant to PROMESA 202(d)(1)(B), the Oversight Board sends the Legislature a notice of violation, as needed.
- Pursuant to PROMESA 202(d)(2), the Legislature submits a revised proposed Fiscal Year Budget.
- Pursuant to PROMESA 202(e), the Oversight Board expects to certify the Fiscal Year Budget.

Federal grant funds can be carried over a specified amount of time, upon request to, and approval by the federal agencies. The financial statement is presented at the programmatic level. However, budgetary control and accounting is exercised at a lower level providing management with detailed control over expenditures at an appropriated budget level. Budgetary Comparison Schedule is not legally required to do so.

### C. Compensated Absences

The Department employees are granted 30 days of vacation and 18 days of sick leave annually. Vacation may be accumulated up to a maximum of 60 days and sick leave up to a maximum of 90 days. In the event of an employee resignation, the employee is paid for accumulated vacation days up to the maximum allowed. Separation from employment prior to use of all or part of the sick level terminates all rights for compensation, except for employees with ten years of service who are entitled to sick leaves pay up to the maximum allowed.

After the approval of Act No. 8 of February 6, 2017, the Department's new 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, except for employees with ten years of service who are entitled to sick leave pay up to the maximum allowed. The Department does not accrue a liability for compensated absences.

### D. 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.

continue



## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### E. Interfund Transactions

The Department has the following types of transactions among funds:

**Interfund Transfers** – Legally required transfers that are reported when incurred as transfer-in by the recipient fund and as transfer-out by the disbursing funds.

### F. Risk Financing

The Department is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions, injuries to employees' health, and natural disasters. Commercial insurance policies covering such risk are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities and Commonwealth of Puerto Rico instrumentalities. Also, principal officials of the Department are covered under various surety bonds. Management believes such coverage is sufficient to preclude any significant uninsured losses to the Department. Amount paid during the fiscal year amounted to \$535,692.

The Department carries insurance coverage for death and bodily injuries caused by the motor vehicles accidents. The insurance is obtained through the Automobile Accidents Compensation Administration (AACCA), a component unit of the Commonwealth of Puerto Rico. This insurance is compulsory for all licensed vehicles used on public roads and highways in Puerto Rico. The annual premium is \$35 per licensed motor vehicle, which is paid directly to AACCA.

The Department obtains workers compensation insurance through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth of Puerto Rico. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Cost of insurance allocated to the Department and deducted from the state appropriation for the year ended June 30, 2019 amounted to \$260,748.

The Department obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth of Puerto Rico (DOLHR). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because work or employment-related accidents or non-occupational disability and drivers' insurance premiums are paid to DOLHR on a cost reimbursement basis.

### G. 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.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

In addition, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the Department's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the Department 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 charges 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 No. 68* is required to be implemented simultaneously with the provisions of GASB No. 68.

Changes resulting from GASB No. 68 requirements apply only to the government-wide financial statements. GASB 68 does not apply to governmental funds financial statements or cash basis of accounting used by the Department; they will continue to report pension expenditures based on contributions made during the year. There is no change in cash flow, contribution rates or General Fund budgeted expenditures associated with implementation of GASB No. 68. In addition, the new measure used to recognize pension expense and pension liability eliminated the Annual Required Contribution (ARC) concept for recognizing pension expense, resulting in the separation of accounting from funding.

The Department adopted the provisions of Codification of Governmental Accounting and Financial Reporting Standard Section Pe5, Pension Plans – Defined Benefit, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

The Department accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying financial statement are equal to the statutorily required contributions.

On May 21, 2017, the Oversight Board, on behalf of the Government of Puerto Rico, filed a petition for the ERS to avail itself of Title III protections of PROMESA. With the submission of the petition under Title III of PROMESA, a process of restructuring of the obligations of said system under the supervision of the United States District Court for the District of Puerto Rico was initiated. Faced with this situation, the Puerto Rico Legislature Assembly approved the Act No. 106 on August 23, 2017, to ensure that retirees continue to receive their pensions, protect the individual contributions of public employees and protect the future of them. In addition, as a corrective measure, the contributions of public employees must be segregated and protected, and a New Defined Contribution Plan was established to ensure the future of public employees. Accordingly, a Defined Contribution Account, a trust account, separated from the general assets and accounts of the Government, was created as of July 1, 2017 in the name of each Participant, as established in Chapter 3 of this Act.

## 3. CASH WITH FISCAL AGENTS (DEPARTMENT OF THE TREASURY OF THE COMMONWEALTH OF PUERTO RICO)

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

continue

**3. CASH WITH FISCAL AGENTS (TREASURY DEPARTMENT OF THE COMMONWEALTH OF PUERTO RICO)**

***Custodial Credit Risk***

This is the risk that, in the event of the failure of a depository financial institution, the Department 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, as amended, adopted by the Department may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, or banker's acceptance. Therefore, Department's management has concluded that on June 30, 2019, the custodial credit risk associated with the Department's cash and cash equivalents is considered low.

**4. FUND ADVANCES**

The Department receives fund advances from the Treasury Department of Puerto Rico for the interim financing of federal programs, as authorized by Act No. 21 of 1979. This Act establishes that all fund advances made will be reimbursed to the General Fund of the Commonwealth's Treasury as the corresponding federal funds are received. During the fiscal year ended June 30, 2019, funds were advanced to the Department for this purpose.

**5. LEASE COMMITMENTS**

The Department is obligated under certain lease accounted for as operating lease. Operational lease not granted property rights or tenant obligations; therefore, neither the assets nor liabilities of leasing arrangement are reflected in the accounting records. Rent paid during the year that ended on June 30, 2019 under month to month basis lease agreement amounted to \$36,000. This amount should be approximately the same expenditures in the following fiscal year.

**6. PENSION PLAN**

***Description of the Plan***

Employees of the Department participate in the Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (ERS) administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration. The ERS is cost-sharing multiple-employer contributory, hybrid defined benefit pension plan sponsored by the Commonwealth under the Act No. 447, approved on May 15, 1951, as amended (Act No. 447) and began operation on January 1, 1952, at which date, contributions by employers and participating employees commenced. The ERS is a pension trust of the Commonwealth. All qualified permanent and probationary employees of the Commonwealth and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems are eligible to participate in the ERS. As of June 30, 2015, there were 206 participating employers (73 Commonwealth agencies, 78 municipalities, and 55 public corporations, including the ERS). The ERS, as a governmental retirement plan, is excluded from the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

On July 1, 2015, membership of the ERS consisted of the following:

Retirees and beneficiaries currently receiving benefits	109,649
Current participating employees	119,679
Disabled members, receiving benefits	<u>15,444</u>
Total membership	<u>244,772</u>

## 6. PENSION PLAN – continuation

Certain provisions are different for the three groups of members who entered the ERS prior to July 1, 2015 as described below:

- Members of Act No. 447 are generally those members hired before April 1, 1990 (Defined Benefit Program)
- Members of Act No. 1 are generally those members hired on or after April 1, 1990 and on or before December 31, 1999 (Defined Contribution Program)
- Members of Act No. 305 are generally those members hired on or after January 1, 2000 and on or before June 30, 2013 (Define Contribution Hybrid Program). Each member has a no forfeitable right to the value of his/her account. Members have three options to invest their contributions. Investment income is credited to the member's account semiannually. The Commonwealth does not guarantee benefits at retirement age.

All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the Defined Benefit Program and the Define Contribution Hybrid Program, and were rehired on or after July 1, 2013, become members of the Define Contribution Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs will become part of the Defined Contribution Hybrid Program.

Each member has a no forfeitable right to the value of his/her account. Members have three options to invest their contributions. Investment income is credited to the member's account semiannually. The Commonwealth does not guarantee benefits at retirement age.

The assets of the Defined Benefit Program, the Defined Contribution Program and the Contribution Hybrid Program are pooled and invested by the ERS. Future benefit payments will be paid from the same pool of assets.

### ***Participant of the Program***

Shall mean, until June 30, 2013, every person for whom the Administrator maintains an account under the Retirement Savings Account Program pursuant to the provisions of Chapter 3 of Act No. 447. Beginning on July 1, 2013, it shall mean every person for whom the Administrator maintains an account under the Defined Contribution Hybrid Program pursuant to the provisions of Chapter 5 of this Act.

The members of the ERS include all regular full-time and non-municipal temporary employees who are not contributing to other Retirement Systems (Article 1-104 and 1-105). Employees include those in the following categories:

- Police of Puerto Rico,
- Firefighters of Puerto Rico,
- Elective officers of the People of Puerto Rico and the employees of the Legislature,
- Officers and employees of the Government of Puerto Rico,
- Officers and employees of public enterprises,
- Officers and employees, including mayors, of the municipalities, and
- Irregular personnel fulfilling the requirements of regular employee.

Membership in the ERS is mandatory, except for the Governor of Puerto Rico, Government Secretaries, heads of public agencies and instrumentalities, the Governor's aides, gubernatorial appointees of commissions and boards, members of the Legislature, the Comptroller of Puerto Rico, the employees of the Agricultural Extension Service of the U.P.R., the Ombudsman and the Commonwealth Election Board employees (Article 1-105). In addition, membership is optional for eligible employees while working and residing outside the territorial limits of the Commonwealth of Puerto Rico (Act No. 112 of 2004).

continue

**6. PENSION PLAN – continuation**

As of July 1, 2013, every employee who is a participant of the ERS, including mayors, regardless of the date when he/she was first appointed to the Government of the Commonwealth of Puerto Rico, its instrumentalities, municipalities or participating employers of the ERS, shall become part of the Defined Contribution Hybrid Program.

Notwithstanding the fact that a superannuation retirement annuity is payable for life, if annuitants return to the service, the payment of their annuity shall be suspended. After an annuitant separates from service, payment of the suspended annuity shall resume, and he/she shall also have the option to withdraw the contributions made since the date he/she returned to service up until he/she separates from service if, after returning to service, he/she worked less than five (5) years or accrued contributions for less than ten thousand dollars (\$10,000). In the event the annuitant worked five (5) years or more and contributed ten thousand dollars (\$10,000) or more, after returning to service, he/she shall be entitled, after his/her separation from service and after reaching the age established in Section 5-110 of Act No. 447, to receive an additional annuity computed pursuant to Section 5-110 of this Act, based on the contributions made since the date said annuitant returned to service until his/her separation from it.

This summary of plan provisions is intended to describe the essential features of the plan. All eligibility requirements and benefit amounts shall be determined in strict accordance with the plan document itself.

**(1) Creditable Service**

- (a) *Creditable Service for Act No. 447 members* – the years and months for plan participation, during which contributions have been made, beginning on the later of date of hire or January 1, 1952 and ending on date of separation from service. For purposes of calculating Creditable Service, the following schedule shall apply:

<b>Service During a Fiscal Year</b>	<b>Creditable Service Earned</b>
15 days during the same month	1 month
2 months and 15 days to 5 months and 14 days	½ year
5 months and 15 days to 8 months and 14 days	¾ year
8 months and 15 days to 12 months	1 years

*Note: All the days must be during the same month.*

In general, Creditable Service may be earned for any period of employment during which no contributions were made if Accumulated Contributions for such periods are paid to the ERS. The same rules hold for rehired employees who previously received a refund of Accumulated Contributions at separation (Article 1-106). Creditable Service also includes purchased service, if any (Article 1-106).

- (b) *Creditable Service for Act No. 1 members* – the years and completed months of plan participation, during which contributions have been made, beginning on date of hire and ending on date of separation from service (Article 1-106 and 2-109). For purposes of calculating Creditable Service, the following schedule shall apply:

<b>Service During a Fiscal Year</b>	<b>Creditable Service Earned</b>
Less than 3 months	None
3 to 5 months	½ year
6 to 8 months	¾ year
9 months or more	1 years

**6. PENSION PLAN – continuation**

In general, Creditable Service may be earned for any period of employment during which no contributions were made if Accumulated Contributions for such periods are paid to the ERS. The same rules hold for rehired employees who previously received a refund of Accumulated Contributions at separation (Article 1-106). Creditable Service also includes purchased service, if any (Article 1-106).

**(2) Service Retirements**

- (a) *Eligibility for Act No. 447 Members* – members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 447 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 58 with 10 years of credited service, (3) any age with 30 years of credited service, (4) for Public Officers in High Risk Positions (the Commonwealth Police and Firefighter Corps, the Municipal Police and Firefighter Corps and the Custody Office Corps), attainment of age 50 with 25 years of credited service, and (5), for Mayors of municipalities, attainment of age 50 with 8 years of credited service as a Mayor. In addition, Act No. 447 members who attained 30 years of credited service by December 31, 2013 are eligible to retire at any time.

Act No. 447 members who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire upon attainment of the retirement eligibility age shown in the table below with 10 years of credited service.

Date of Birth	Attained Age as of June 30, 2013	Retirement Eligibility Age
July 1, 1957 or later	55 or less	61
July 1, 1956 to June 30, 1957	56	60
Before July 1, 1956	57 and up	59

In addition to the requirements in the table above, Act No. 447 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013, and did not attain 30 years of credited service by December 31, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

- (b) *Eligibility for Act No. 1 Members* – members who were eligible to retire as of June 30, 2013, continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 1 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 65 with 10 years of credited service, (3) for Public Officers in High Risk Positions, any age with 30 years of credited service, and (4) for Mayors, attainment of age 50 with 8 years of credited service as a Mayor.

Act No. 1 members who were not eligible to retire as of June 30, 2013, are eligible to retire upon attainment of age 65 with 10 years of credited service. In addition, Act No. 1 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013, are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

- (c) *Eligibility for System 2000 Members* – members who were eligible to retire as of June 30, 2013, continue to be eligible to retire at any time. Prior to July 1, 2013, System 2000 members could retire upon attainment of age 55 for Public Officers in High Risk Positions and attainment of age 60 otherwise.

System 2000 members who were not eligible to retire as of June 30, 2013, are eligible to retire upon attainment of age 55 for Public Officers in High Risk Positions and upon attainment of the retirement eligibility age shown in the table below otherwise.

continue

6. PENSION PLAN – continuation

Date of Birth	Attained Age as of June 30, 2013	Retirement Eligibility Age
July 1, 1957 or later	55 or less	65
July 1, 1956 to June 30, 1957	56	64
July 1, 1955 to June 30, 1956	57	63
July 1, 1954 to June 30, 1955	58	62
Before July 1, 1954	59 and up	61

- (d) *Eligibility for Members Hired after June 30, 2013* – attainment of age 58 if a Public Officer in a High-Risk Position and attainment of age 67 otherwise.

**(3) Service Retirement Annuity Benefits**

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

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

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

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

If the Act No. 447 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. Except for Commonwealth Police and Commonwealth Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

continue

**6. PENSION PLAN – continuation**

For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to \$6,600 multiplied by years of credited service up to 20 years, plus 1.5% of average compensation in excess of \$6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of \$6,600 multiplied by years of credited service in excess of 20 years. Except for Police and Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

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

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

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

For all other Act No. 1 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayoral credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral credited service in excess of 20 years. Non-Mayoral credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

- (c) *Coordination with Social Security Act for Act No. 447 Members* – Except for police, mayors and employees of the Agricultural Extension Service of the U.P.R., participants may elect to coordinate coverage under the ERS with Federal Social Security by selecting the lower of two contribution options. Those participants selecting Option (1), the Coordination Plan, are subject to a benefit recalculation upon attainment of Social Security Retirement Age. Those participants selecting Option (2), the Supplementation Plan, will continue to receive the same benefits for life, without any adjustment at SSRA. At any time, up to retirement, participants may change from Option (1) to Option (2) by making a contribution including interest to the ERS, retroactive to the later of July 1, 1968 or the date of plan entry, that will bring their career Accumulated Contributions to the Option (2) level. All police, mayors and employees of the Agricultural Extension Service of the U.P.R. are covered under Option (2), the Supplementation Plan.

**(4) Compulsory Retirement**

All Act No. 447 and Act No. 1 Public Officers in High Risk Positions must retire upon attainment of age 58 and 30 years of credited service. A two-year extension may be requested by the member from the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps, or supervising authority as applicable.



**6. PENSION PLAN – continuation**

**(5) Early Retirement Incentive Program of 2015**

Act No. 211 of December 8, 2015 (Act 211-2015), as amended by Act No. 170-2016, is an early retirement incentive program. All employers participating in ERS are eligible to apply to participate in Act 211-2015. Qualification is conditioned upon approval by the Office of Management and Budget (OMB) of the agency's plan to implement such program and its impact on the agency.

Act 211-2015 states that employers who have outstanding debt with ERS must enter into a payment plan that includes using a portion of the employer's savings from Act 211-2015 in order to pay the outstanding debt. Eligible employees are Act 447 members in ERS who have at least 20 years of service at the time of enrollment in the program, and who, except for Police, are not already eligible to retire under Act 447. Under Act 211-2015, employees who elect to participate in the program will receive a variety of benefits, some of which do not impact ERS. The benefits which impact ERS are as follows:

- (a) Contributions to the Defined Contribution Hybrid Program while enrolled in the program equal to 10% of the average compensation as of December 31, 2015, paid in full by the employer until the member reaches age 61. Note that employer contributions will also be paid to the System on this basis.
- (b) Upon death while enrolled in the program prior to age 61, participation in the program will end and the death benefits payable to survivors if any will be the same as for an active Act 447 member.
- (c) Upon attainment of age 61, the employee will begin collecting retirement benefits from ERS, with a guarantee at the time of retirement that the retirement benefit will be at least 50% of average compensation as of June 30, 2013 (60% for Puerto Rico Police provided the agency pays for the increase from 50% to 60%). Benefits for Coordination Plan members (which decrease upon attainment of Social Security Retirement Age) can never be less than 50% of average compensation as of June 30, 2013. The agency shall pay an additional contribution to ERS to cover the cost of providing this additional minimum benefit.

**(6) Termination Benefits**

**(a) Lump Sum Withdrawal**

*Eligibility:* A Member is eligible upon termination of service prior to 5 years of service or if the balance in the hybrid contributions account is \$10,000 or less.

*Benefit:* The benefit equals a lump sum payment of the balance in the hybrid contribution account as of the date of the permanent separation of service.

**(b) Deferred Retirement**

*Eligibility:* A member is eligible upon termination of service with 5 or more years of service (10 years of credited service for Act No. 447 and Act No. 1 members) prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal of the accumulated contributions and the hybrid contribution account.

*Benefit:* An annuity payable for the lifetime of the member commencing at the applicable retirement eligibility age equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447 and Act No. 1 members, the accrued benefit determined as of June 30, 2013.

continue

6. PENSION PLAN – continuation

(7) **Death Benefits**

(a) **Pre-Retirement Death Benefit**

*Eligibility:* Any current non-retired member is eligible.

*Benefit:* A refund of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members.

(b) **High-Risk Death Benefit under Act No. 127**

*Eligibility:* Police, firefighters, and other employees in specified high-risk positions who die in the line of work due to reasons specified in Act No. 127 of 1958, as amended.

*Spouse's Benefit:* 50% of the participant's compensation at date of death, payable as an annuity until death or remarriage.

*Children's Benefit:* 50% of the participant's compensation at date of death, payable as an annuity, and allocated pro-rata among eligible children. The annuity is payable for life for a disabled child, until age 18 for a nondisabled child not pursuing studies, and until age 25 for a nondisabled child who is pursuing studies.

*Benefit if No Spouse or Children:* The parents of the member shall each receive 50% of the participant's compensation at date of death, payable as an annuity for life.

*Post-death Increases:* Effective July 1, 1996 and subsequently every three years, the above death benefits are increased by 3% provided that the beneficiary(ies) had been receiving payments for at least three years.

The cost of these benefits is paid by the Commonwealth's General Fund.

(c) **Post-Retirement Death Benefit for Members who Retired prior to July 1, 2013**

*Eligibility:* Any retiree or disabled member receiving a monthly benefit who has not elected a reversionary annuity and whose benefits commenced prior to July 1, 2013.

*Benefit:* The benefit is as follows (Act No. 105, as amended by Act No. 4):

- (i) For those married or with dependent children at the time of death, the annual income to a widow, or widower or dependent children is equal to 60% (50% if in the Coordination Plan – 30% prior to January 1, 2004) of the retirement benefit payable for life for a surviving spouse and/or disabled children and payable until age 18 (age 25 if pursuing studies) for nondisabled children. If in the Coordination Plan, the benefit to the surviving spouse does not begin until the spouse's attainment of age 60 and the surviving spouse must have been married to the member for at least 10 years to be eligible for this benefit. The increase in the percentage from 30% to 50% if in the Coordination Plan is paid by the General Fund for former government employees or by the public enterprise or municipality for their former employees.

**6. PENSION PLAN – continuation**

- (ii) The benefit, when there is no relation as stated above, is equal to the remaining balance of accumulated contributions at the time of retirement after the deduction of lifetime annual income paid and is payable to a beneficiary or to the member's estate. In no case, shall the benefit be less than \$1,000. Either the Commonwealth's General Fund for former government employees or the public enterprise or municipality for their former employees pays the difference, up to \$250, between (1) the accumulated contributions less the lifetime annual income paid and (2) \$1,000. The ERS pays for the rest.

**(d) Post-Retirement Death Benefit for Members who began receiving a monthly benefit after to June 30, 2013**

*Eligibility:* Any retiree or disabled member who has not elected a reversionary annuity and whose benefits commenced prior to July 1, 2013.

*Benefit:* If the member elected at the time of retirement to transfer a portion of the annuity to a beneficiary by selecting an actuarially equivalent optional form of payment, the applicable survivor benefit.

For all members, the excess, if any, of the hybrid contribution account, plus the accumulated contributions for Act No. 447 and Act No. 1 members, at the time of retirement over the total annuity payments paid to the member and any beneficiary per the terms of the optional form of payment shall be payable to a beneficiary or the member's estate.

**(e) Beneficiaries receiving occupational death benefits as of June 30, 2013 continue to be eligible to receive such benefits**

**(8) Disability Benefits**

**(a) Disability**

*Eligibility:* All members are eligible upon the occurrence of disability.

*Benefit:* The balance of the hybrid contribution account payable as lump sum distribution, an immediate annuity or a deferred annuity at the election of the participant. Act No. 447 and Act No. 1 members remain eligible to receive the accrued benefit as of June 30, 2013 commencing at the applicable retirement eligibility age.

**(b) High-Risk Death Benefit under Act No. 127**

*Eligibility:* Police, firefighters, and other employees in specified high-risk positions who disabled in the line of work due to reasons specified in Act No. 127 of 1958, as amended.

*Benefit:* 80% (100% for Act No. 447 members) of compensation as of date of disability, payable as an annuity. If the member dies while still disabled, this annuity benefit continues to his beneficiaries. Beneficiaries include the surviving spouse and/or disabled children (for life), nondisabled children until age 18 (age 25 if pursuing studies), and the parents if no other beneficiaries. Effective July 1, 1996 and subsequently every three years, the disability benefit is increased by 3% provided that the member (or beneficiary) had been receiving payments for at least three years (Act No. 127 of 1958, as amended). The cost of these benefits is paid by the Commonwealth's General Fund.

**(c) Members who qualified for occupational or non-occupational disability benefits as of June 30, 2013 continue to be eligible to receive such benefits.**

6. PENSION PLAN – continuation

**(d) Disability Insurance**

The Administrator, with the approval of the Board, shall establish a disability benefits program, which shall provide a temporary annuity in the event of total and permanent disability. Disability benefits may be provided through one or more disability insurance contracts with one or more insurance companies authorized by the Insurance Commissioner of Puerto Rico to conduct business in Puerto Rico. The determination as to whether a person is partially or totally and permanently disabled, shall be made by the insurance company that issues the insurance policy covering the person. All the participants of the Program who are employees shall avail themselves to the disability benefits program in the manner and form established by the Administrator. During fiscal year 2016-2017 the disability insurance amounted to \$2,283,719.

**(9) Special Benefits**

**(a) Minimum Benefits**

**(i) Past Ad hoc Increases**

The Legislature, from time, increases pensions for certain retirees as described in Act No. 124 approved on June 8, 1973 and Act No. 23 approved on September 23, 1983. The benefits are paid 50% by the Commonwealth's General Fund and 50% by the ERS.

**(ii) Minimum Benefit for Members who Retired before July 1, 2013 (Act No. 156 of 2003, Act No. 35 of 2007, and Act No. 3)**

The minimum monthly lifetime income for members who retired or become disabled before July 1, 2013 is \$500 per month effective July 1, 2013 (\$400 per month effective July 1, 2007 and \$300 per month up to June 30, 2007). The increase in the minimum monthly benefit from \$200 per month to \$300 per month is paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees. The increase in the minimum monthly benefit from \$300 per month to \$400 per month is to be paid by the ERS for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

**(iii) Coordination Plan Minimum Benefit**

A minimum monthly benefit is payable upon attainment of SSRA such that the benefit, when added to the Social Security Benefit, is not less than the benefit payable prior to SSRA.

**(b) Cost-of-Living Adjustments (COLA) to Pension Benefits**

The Legislature, from time to time, increases pensions by 3% for retired and disabled members. Beneficiaries are not entitled to COLAs granted after the retiree's death. The first increase was granted by Act No. 10 of 1992. Subsequent 3% increases have been granted every third year since 1992, with the latest 3% increase established on April 24, 2007 and effective July 1, 2007 (retroactive to January 1, 2007) for retired and disabled members that were receiving a monthly benefit on or before January 1, 2004 less than \$1,250 per month received an increase of up to 3% without exceeding the limit of \$1,250 per month. The COLAs granted in 1992 to all retirees and in 1998 to retirees who are former government or municipal employees shall be paid by the ERS. All other COLAs granted in 1995 and later shall be paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

continue

6. PENSION PLAN – continuation

**(c) Special “Bonus” Benefits**

(i) Christmas Bonus (Act No. 144, as Amended by Act No. 3)

An annual bonus of \$200 for each retiree, beneficiary, and disabled member paid in December provided the member retired prior to July 1, 2013. This benefit is paid from the supplemental contributions received from the Commonwealth’s General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

(ii) Medication Bonus (Act No. 155, as Amended by Act No. 3)

An annual bonus of \$100 for each retiree, beneficiary, and disabled member to cover health costs paid in July provided the member retired prior to July 1, 2013. Evidence of coverage is not required. This amount is prorated if there are multiple beneficiaries. This benefit is paid from the supplemental contributions received from the Commonwealth’s General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

**(10) Contributions**

**(a) Member Contributions**

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

Prior to July 1, 2013, contributions by Act No. 447 members selecting the Coordination Plan were 5.775% of compensation up to \$6,600 plus 8.275% of compensation in excess of \$6,600. Contributions by all other members were 8.275% of compensation. System 2000 members may also have voluntary contribution of up to 1.725% of compensation prior to July 1, 2013.

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

Prior to July 1, 2011, employer contributions were 9.275% of compensation. On July 6, 2011, the Commonwealth enacted Act No. 116, increasing the employers’ contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2011-2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

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

Effective July 1, 2013, the ERS will receive a supplemental contribution of \$2,000 each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefiting as an Act No. 447 or Act No. 1 member while an active employee. This supplemental contribution will be paid by the Commonwealth’s General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

continue

**6. PENSION PLAN – continuation**

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

The additional uniform contribution (AUC) will be certified by the external actuary of the ERS each fiscal year from 2014-2015 through 2032-2033 as necessary to avoid having the projected gross assets of the ERS, during any subsequent fiscal year, to fall below \$1 billion. The AUC is to be paid by the Commonwealth's General Fund, public corporations with own treasuries, and municipalities.

Only a fraction of the AUC from prior years has been received by the ERS.

**(11) Service Purchase**

Prior to July 1, 2013, active members with eligible service from prior employment may elect to purchase service in ERS. The cost of the purchase is calculated by applying the ERS statutory contribution rates to the member's salary during the years of service at the former employer. The amount due to member contributions is accumulated at 9.5% per year (6% prior to April 4, 2013) until 6 months after the time of the service purchase request. Any amount not covered by asset transfers from the member's prior pension fund is payable by the member (Act No. 10 of 1992, Act No. 14 of 1981, Act No. 122 of 2000, Act Nos. 203 and 33 of 2007). Effective July 1, 2013, only veterans may purchase service for time spent under military service are permitted to make voluntary contributions to the Defined Contribution Hybrid Contribution Account during the years of military leave.

**(12) Early Retirement Programs**

On July 2, 2010, the Commonwealth Enacted Act No. 70 of 2010 (Act No. 70) establishing a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined. Additional window periods occurred through December 31, 2012. Under Section 4A of Act No. 70, active members could terminate employment immediately and receive a bonus equal to one, three, or six months of salary (paid by the Commonwealth). Under Section 4B of Act No. 70, active members who had at least 15 years of service, but less than 30 years of creditable services, could retire immediately with an enhanced benefit ranging from 37.5% to 50% of salary. This enhanced benefit is paid by the General Fund for government employees and Public Corporation for their employees until the member reaches the later of age 55 or the date the member would have completed 30 years of service had the member continued working. The ERS will pay the benefit after this time period.

While the General Fund / Public Corporation is paying the pension benefit to the member or any surviving beneficiary, the General Fund / Public Corporation will also pay a contribution equal to the employer contribution rate [(12.275% for the 2013-2014 fiscal year plus the employee contribution rate for Public Corporation (currently 10%)] of final salary to the ERS. The employer contribution rate applied to final salary increases as under Act No. 116 to a rate of 20.525% of payroll in 2020-2021 and thereafter. Under Section 4C of Act No. 70, active members who had at least 30 years of service could retire immediately and receive a bonus equal to six months of salary (paid by Commonwealth). For any active employee who retired under Section 4C, the Public Corporation will pay a contribution equal to the employer contribution rate (12.275% for 2013-2014 fiscal year, increasing to 20.525% in 2020-2021 and thereafter) plus the employee contribution rate (currently 10%) of final salary to the ERS for five years after retirement.

During fiscal year 2018-2019 the amount of \$ 619,000 was allocated by the Legislature as part of the Joint Budget Resolution for payment under Act No. 70.

**6. PENSION PLAN – continuation**

The contribution requirement to the ERS is established by law and is not actuarially determined. The special benefits contributions of approximately \$229 million in 2014 mainly represent contributions from the General Fund, public corporation and municipalities for the special benefits identified above granted by special laws. The funding of the special benefits is provided to the ERS through legislative appropriations each July 1 by the General Fund for former government and certain public corporations without own treasuries employees, and by certain public corporations with own treasuries and municipalities for their former employees. The legislative appropriations are considered estimates of the payments to be made by the ERS for the special benefits. Deficiencies in legislative appropriations are covered by the ERS's own funds until recovered through future legislative appropriations. Any surplus of legislative appropriations collected over special benefits paid is combined with the assets held in trust for the payment of other pension benefits.

**(13) Changes in Plan Provisions since Prior Valuation**

Act No. 211-2015 is an early retirement incentive program that was passed on December 8, 2015 which was amended by Act No. 170-2016 to expand the eligible group of members. No retirements due to Act No. 211-2015 or Act No. 170-2016 have occurred as of the June 30, 2016 measurement date of this valuation. Impacts of Act No. 211-2015 and Act No. 170-2016 will be reflected in future valuation. Impacts of Act No. 211-2015 and Act No. 170-2016 will be reflected in future valuations when retirements have actually occurred, and census data is available.

**(14) Other Postemployment Benefits (OPEB) – Healthcare Benefits**

ERS Medical Insurance Plan Contribution (MIPC) is an unfunded, cost-sharing, multi-employer defined benefit other postemployment benefit plan sponsored by the Commonwealth. ERS MIPC covers a payment of up to \$100 per month to the eligible medical insurance plan selected by the member provided the member retired prior to July 1, 2013 (Act No. 483, as amended by Act No. 3). Substantially all fulltime employees of the Commonwealth's primary government, and certain municipalities of Puerto Rico and certain component units of the Commonwealth not having their own postemployment benefit plan, were covered by the OPEB. Commonwealth employees became members upon their date of employment. Plan members were eligible for benefits upon reaching the pension benefits retirement ages.

At July 1, 2015, the membership, as adjusted by changes in participants established by Act No. 3, consisted of the following:

<b>Membership</b>	<b>Amount</b>
Retired Members	94,979
Disabled Members	<u>15,444</u>
Total Membership	<u>110,423</u>

The contribution requirement of ERS Medical Insurance Plan Contribution (MIPC) is established by Act No. 95 approved on June 29, 1963. This benefit is financed on a pay-as-you-go basis from the General Fund of the Commonwealth. Since this benefit is not funded in advance, the ARC for this benefit has been calculated based on an assumed investment return rate of 3.00% based on the asset allocation of the Commonwealth's general assets that are used to pay this benefit. There is no contribution requirement from the plan member during active employment. Retirees contribute the amount of the healthcare insurance premium not covered by the Commonwealth contribution. As a result, these OPEB are 100% unfunded. During the year ended June 30, 2016, OPEB contributions amounted to \$106 million.

continue

## 6. PENSION PLAN – continuation

The funding of the OPEB benefits is provided to the ERS through legislative appropriations each July 1 by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees, and by certain public corporations with own treasuries and municipalities for their former employees. The legislative appropriations are considered estimates of the payments to be made by the ERS for the healthcare benefits throughout the year.

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 67 *Financial Reporting for Pension Plans*, and No. 68, *Accounting and Financial Reporting for Pensions* should be made. As of June 30, 2019, the PRGERS hasn't issued, or made available information in order to properly adjust or disclose any deferred outflow/inflow of resources, or net OPEB obligation, if any, applicable to the Commonwealth.

### ***Liquidity Risk and Uncertainties***

ERS is a mature retirement system with a significant retiree population. Based on the statutory funding requirements, the annual benefit payments and administrative expenses paid by the ERS were significantly larger than the member and employer contributions made to the ERS. Thus, investment income must have had to be used to cover negative cash flow. If the increasing and additional contributions stipulated by law are not paid in full on an annual basis, the ERS will continue being rapidly defunded and gross assets will be exhausted. If measures are not taken to significantly increase the contributions, the ERS will become insolvent in fiscal year 2018. In addition, annual cash flow estimates for the foreseeable future are presently estimated to be insufficient to cover the ERS's obligations unless other measures are taken.

If the ERS's assets are exhausted it would be operating solely on a "pay-as-you-go" basis, which means that it would be unable to pay benefits that exceed the actual employer and employee contributions received (net of administrative and other expenses), unless the Commonwealth provides the funding required to meet the pay-as-you-go retirement benefits. Additionally, future employers' contributions have been pledged for the payment of debt service, further depletion of the ERS's assets could result in the inability to repay its bond obligations. Consequently, the ERS's funding requirements, together with the funding requirements of JRS and the Puerto Rico System of Annuities and Pensions for Teachers, could have a direct negative effect on the Commonwealth's General Funds, since the Commonwealth is the primary sponsor and is obligated to make contributions to fund each of the ERS.

The Commonwealth and the other participating employers have been facing several fiscal and economic challenges in recent years due, among other factors, to continued budget deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. The widening of credit spreads for the Commonwealth's public sector debt, the continued downgrading of the Commonwealth's credit ratings and those of many of its instrumentalities to noninvestment grade categories, and the lowered-than-projected revenues have put further stain on the Commonwealth liquidity and have affected its access to both the capital markets and private sources of financing, as well as the borrowing cost of any such funding.

If the Commonwealth's financial condition does not improve as a result of fiscal and budgetary measures it is taking, its ability to repay its obligations, including its regular employer contributions to the ERS and its additional contributions as provided by Act No. 32 of June 25, 2013 (Act No. 32), for the upcoming years, may continue to be adversely affected, and could also affect the payment of benefits and the repayment of the ERS's bond payable.

To improve the liquidity and solvency of the ERS, the Commonwealth enacted Act No. 32, as amended by Act No. 244 of 2014, which provides for incremental annual contributions (Additional Uniform Contribution) from the Commonwealth's General Fund, public corporations and municipalities beginning in fiscal year 2014 and up to the fiscal year 2033.



## 6. PENSION PLAN – continuation

For fiscal year 2015 and 2016, the certification of the AUC was not available at least 120 days before the commencement of the applicable fiscal year. ACT No. 32, as amended, provides that in this situation, the AUC for fiscal year will be the AUC applicable for the preceding year. Thus, the AUC determined for fiscal years 2015 and 2016 was \$120 million.

Timely payment of the AUC is a critical component of the reform in order for the ERS to be able to make payments as they come due without depleting all its assets first. However, as a result of continued budget deficits in fiscal years 2014 and 2015, the Commonwealth and other participating employers have been unable to make the AUC required in full for these fiscal years (other than \$34.4 million paid by municipalities and public corporations for fiscal year 2014 and \$22.7 million paid by the Commonwealth and \$37.1 million paid by public corporations and municipalities for fiscal year 2015). In February 2016, the ERS's actuaries recalculated the AUC for fiscal year 2017 and subsequent years. Based on certain assumptions (which do not account for any fiscal adjustment that the Commonwealth may undertake to address its fiscal challenges), the projected AUC for fiscal year 2017 and subsequent years was approximately \$596.0 million (of which approximately \$370.0 million corresponds to the Commonwealth, to be funded from its General Fund, and the remaining portion corresponds to the participating public corporations and municipalities).

### ***Remediation Plan***

To improve the liquidity and solvency of the ERS, on July 6, 2011, the Commonwealth enacted Act No. 116 increasing the employers' contribution rate from 9.275% to 10.275% of employee compensation for the 2011-2012 fiscal year, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020.

On April 4, 2013, the Legislature enacted Act No. 3 which amended the Act No. 447, Act No. 1, and Act No. 305. Act No. 3 reformed the ERS by, among other measures, reducing benefits, increasing employee contributions, and, in the case of active employees who were entitled to the defined benefits program, replacing most of the defined benefits program, replacing most of the defined benefit elements with a defined contribution structure. The reform intended to address the Commonwealth's future cash flow needs and "pay-as-you-go" requirement, while recognizing that the ERS would become insolvent. As such, the reform was intended to provide enough cash for the ERS to be able to pay benefits (as amended through the reform) and debt service on the pension obligation bonds, while maintaining projected ERS gross assets at no less than \$1.0 billion at all times.

To achieve this goal, the reform contemplated that the Commonwealth and other participating employers would have to provide additional annual funding above the statutorily prescribed contributions as required by Act No. 32. As a long-term plan, it was recognized that constant monitoring would be required to ensure that the ERS remained on track to meet the reform's goals. The receipt of the additional uniform contribution of Act No. 32 is critical to the ERS's ability to make payments as they become due.

Act No. 3 established a contributory hybrid program (the Contributory Hybrid Program) like the System 2000 program that will eventually result in all active and retired members participating in a member-funded hybrid program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under Act No. 447 and Act No. 1 (defined benefit program), and thereafter, all future benefits will accrue under the defined contribution formula used for the System 2000 program participants. Ceasing future defined benefit accruals under Act No. 447 and Act No. 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employer contributions available to pay benefits and bonds payable debt service. Act No.3 incorporate the provisions of the Defined Contribution Hybrid Program and System 2000 in Chapter 5 of the ERS.

**6. PENSION PLAN** – continuation

Participants in the defined benefit program who as of June 30, 2013 were entitled to retire and receive a pension, may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants who as of June 30, 2013 were not entitled to retire can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

Participants in the System 2000 program who as of June 30, 2013 had reached the age of 60 may retire on any later date and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program. Participants in the System 2000 program who as of June 30, 2013 had not reached the age of 60 can retire depending on the new age limits defined by the Contributory Hybrid Program and will receive the annuity corresponding to their retirement program, as well as the annuity accrued under the Contributory Hybrid Program.

In addition, Act No. 3 amended the provisions of the different benefit structures under the ERS including, but not limited to, the following:

- Retirement age – The retirement age for the frozen accrued benefits of Act No. 447 is gradually increased from age 58 to age 61, and from age 60 to age 65 for System 2000 program members, which results in a delay in cash outflow and thus lower cumulative future benefit payments to these members. Reduced early retirement was eliminated for Act No. 1, which also results in a delay in cash outflow. The retirement age for new employees was increased to age 67.
- Member contributions – The prior member contribution rate of 8.275% (varying for some members) is increased to 10% of pay. While this will result in higher hybrid program benefits in the future, it will provide more assets in the near term that can support current benefit payments and bonds payable debt service.
- Mandated annuitization – System 2000 program notional accounts were available as lump sum payments at termination/retirement. With a full cohort of active System 2000 program members completing careers at roughly the same time that bonds payable principal payments begin, lump sum payments would have had a deleterious effect on the System's assets. Act No. 3 hybrid accounts, which include the System 2000 program accounts, are subject to mandatory annuitization, which will benefit the System on a cash flow basis by stretching out payments over time, thus providing the System "catch-up" time. The ERS has the authority for determining the annuitization factors and for updating the factors in future years.
- Survivor benefits – Act No. 447 and Act No. 1 offered survivor benefits at no cost to the retiree. For future retirees, the defined benefit portion of the Act No. 447 or Act No. 1 frozen annuity and the hybrid program Act No. 3 annuity with a survivor benefit, resulting in lower future cash outflow.
- The occupational death benefit and the one year of salary death benefit were eliminated for Act No. 447 and Act No. 1 members, resulting in lower future cash outflow.
- Disability benefits, other than those provided under Law No. 127, were eliminated, resulting in lower future cash outflow. (A member who becomes disabled may receive their hybrid account balance and their accrued benefit if applicable under Act No. 447 or Act No. 1.)
- Special law benefits are reduced for current retirees and eliminated for future retirees. The Christmas bonus payable to current retirees was reduced from \$600 to \$200. The summer bonus was eliminated. The employers will continue making contributions to the ERS as if all special law benefits were still in place for current and future Act No. 447 and Act No. 1 retirees, which will result in additional cash that can be used for benefit payments and bonds payable debt service.

continue

## 6. PENSION PLAN – continuation

- Minimum benefits – The minimum pension payable was increase from \$400 to \$500 per month for current retirees only.
- Merit Annuity – The “Merit Annuity” available to participants who joined the ERS prior to April 1, 1990 was eliminated.

Other measures taken to improve the liquidity of the ERS include, among others, 1) revision of the personal loan policy by limiting personal and cultural loan amounts to \$5,000 each, from \$15,000 and \$10,000, respectively; and 2) the receipt of a special contribution from the Commonwealth that was invested in junior subordinated capital appreciation bonds issued by the Puerto Rico Sales Tax Financing Corporation (the COFINA Bonds).

The successful implementation of these measures cannot be assured, as it is dependent upon future events and circumstances whose outcome cannot be anticipated.

### ***Pension Expenses***

The Department Net Pension Liability for each plan program is measured as the proportionate share of the Net Pension Liability. The Net Pension Liability of each of the plan program is measured as of June 30, 2016, and the Total Pension Liability for each plan program used to calculate the Net Pension Liability was determined by an actuarial valuation as of June 30, 2016 rolled forward to June 30, 2017 using standard update procedures. The Department’s proportion of the Net Pension Liability was based on a projection of the Department’s long-term share of contributions to the pension plans program relative to the projected contributions of all participating employers, actuarially determined. As previously mentioned, the Department is part of the Commonwealth of Puerto Rico. Accordingly, at June 30, 2017, the Department’s proportionate share was included as part of the Commonwealth.

#### **(1) Pension Expense**

For the fiscal year ended June 30, 2019, the Department recognized pension expense of \$508,091. As of June 30, 2018, the Department proportionate Deferred Outflows of Resources and Deferred Inflows of Resources related to pensions are included as part of the Commonwealth of Puerto Rico.

### ***Actuarial Methods and Assumptions***

There have been no significant changes between the valuation date of July 1, 2015 and the fiscal year end. For this year, the June 30, 2015 census data used in the prior valuation is also used as the July 1, 2016 census data for the current valuation. The liability results as of June 30, 2016, were based on projecting the ERS obligations determined as of the census data collection date of July 1, 2015 for one year, using roll-forward methods and assuming no liability gains or losses.

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.

For purposes of converting the Defined Contribution Hybrid Contribution Account to a lifetime annuity, the current factors adopted by the Board are the single life annuity factors using an interest rate of 4% and the RP-2000 Healthy Annuitant Mortality Table for ages 50 and over and the RP-2000 Employee Mortality Table for ages under 50, projected to 2025 using Scale AA and blended 50% male / 50% female.

continue

**6. PENSION PLAN – continuation**

A summary of the actuarial assumptions and methods used to calculate the total pension liability as of June 30, 2015 is provided below, including any assumptions that differ from those used in the June 30, 2014 actuarial valuation. Total pension liability represents the portion of the actuarial present value of projected benefit payments attributable to past periods of service for current and inactive employees.

The actuarial valuation used the following actuarial assumptions:

Actuarial Assumptions:	
Inflation	2.5%
Investment Rate of Return	6.55% , Net of Pension Plan Investment, Including Inflation
Municipal Bond Index	2.85% , as per Bond Buyer General Obligation 20 — Bond Municipal Bond Index
Discount Rate	2.85%
Projected Salary Increases	3.00% per year. No compensation increases are assumed until July 1, 2017 as a result of Act No. 66 and the current general economy.
Mortality	<p>Pre-retirement Mortality:</p> <p>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 a generational basis. For members covered under Act 127, RP-2014 Employee Mortality Rates 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 a generational basis. As generational tables, they reflect mortality improvements both before and after measurement date.</p> <p>100.0% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.</p> <p>Post-retirement Healthy Mortality:</p> <p>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 Males and 95% of the rates from the UP-1994 Mortality Table 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. As a generational table, it reflects mortality improvements both before and after the measurement date.</p> <p>Post-retirement Disabled Mortality:</p> <p>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 UP-1994 Mortality Table Males and 115% of the rates from the UP-1994 Mortality Table 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. As a generational table, it reflects mortality improvements both before and after the measurement date.</p>

This valuation also reflects a salary freeze until July 1, 2017 due to Act No. 66 of 2014. While the Act No. 66 salary freeze only applies to Central Government employees, public corporations are mandated to achieve savings under Act No. 66, and actuaries have assumed that they will meet this mandate by freezing salaries. Also, while municipalities are not impacted by Act No. 66, the actuaries have also assumed the salary freeze for these employees due to the current economic conditions in Puerto Rico.

Most other demographic assumptions used in the July 1, 2013 valuation were based on the results of an actuarial experience study using data as of June 30, 2003, June 30, 2005 and June 30, 2007.

***Long-Term Expected Rate of Return***

The valuation reflects no change in the investment return assumption of 6.55% per year for GASB No. 68 purposes. The 6.55% assumption reflects the asset allocation for the non-loan of the portfolio that was adopted by the Board during December 2013 as shown below and Milliman's capital market assumptions as of June 30, 2016. In addition, the assumption reflects that loans to members comprise approximately 20% of the portfolio and, as provided by the ERS, have an approximate return of 9.1% with no volatility.

continue

**6. PENSION PLAN** – continuation

The pension plan’s policy regarding allocation of invested assets is established and may be amended by the ERS’s Board. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the ERS’s financial condition for the benefits provided through the pension programs. The following was the Board’s adopted asset allocation policy as of June 30, 2016:

<b>Asset Class</b>	<b>Target Allocation</b>	<b>Long-Term Expected Rate of Return</b>
Domestic Equity	25%	6.4%
International Equity	10%	7.6%
Fixed Income	64%	3.9%
Cash	<u>1%</u>	2.9%
Total	<u>100%</u>	

Please note that the investment return assumption of 6.55% per year is equal to the highest debt service of the Pension Obligation Bonds. The debt service on the Pension Obligation Bonds ranges from 5.85% to 6.55%.

Under the prior GASB Nos. 25/27, the investment return assumption was used to discount all projected Basic System Pension Benefits and System Administered Pension Benefits to determine the Actuarial Accrued Liability. Under GASB No. 67, the investment return assumption is an input that is used in the calculation of the single equivalent interest rate that is used to discount these benefits to determine the Total Pension Liability. As a result of no change in the investment return assumption, the assumed investment return on the Defined Contribution Hybrid Contribution Accounts (80% of the net investment return assumption) remains at 5.24%.

The projected mortality improvement scale was updated from Scale MP-2015 to Scale MP-2016, which was published by the Society of Actuaries in October 2016. The valuation also reflects a salary freeze until July 1, 2021 due the Act No. 3-2017, four-year extension of Act No. 66-2014. Act 66-2014 mandates a salary freeze only for Central Government employees and mandates savings for public corporations. Due to the Act No. 66-2014 required saving for public corporations and the current economic conditions in Puerto Rico, the salary freeze has also been assumed for public corporation and municipal employees.

***Illiquid Assets***

The Act No. 32 AUC calculation is based on the objective of maintaining a \$1.0 billion gross asset buffer at all times. It is important to note that a material portion of ERS assets are illiquid in nature. Thus, if the Act No. 32 AUC is not paid in full and the \$1.0 billion buffer is not maintained, the ERS will run into liquidity issues and may be forced to sell illiquid assets, potentially at significant loss to the further detriment of the ERS. As of June 30, 2016, ERS had approximately \$771 million in illiquid assets, comprised primarily of loans to ERS members and the COFINA investment. This projection assumes that these illiquid assets will be converted to liquid assets when needed.

The Total Pension Liability was determined by an actuarial valuation as of July 1, 2016, calculated based on the discount rate and actuarial assumptions, and was then projected forward to June 30, 2016. There have been no significant changes between the valuation date of July 1, 2014 and the fiscal year end. Any significant changes during this period must be reflected as prescribed by GASB No. 67. Covered Payroll is as of July 1, 2015.

***Discount Rate***

The asset basis for the date of depletion projection is the ERS’s fiduciary net position (the gross assets plus deferred outflows of resources less the gross liabilities, including the senior pension funding bonds payable, plus deferred inflows of resources). On this basis, the ERS’s fiduciary net position was exhausted in the fiscal year 2015.

continue

6. PENSION PLAN – continuation

The ERS’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 result in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the ERS’s 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 ERS’s fiduciary net position is not projected to be sufficient.

The discount rate on June 30, 2015 and 2016, was as follow:

	June 30, 2015	June 30, 2016
Discount Rate	3.80%	2.85%
Long-term expected rate of return net of investment expense	6.55%	6.55%
Municipal bond rate *	3.80%	2.85%
* Bond Buyer General Obligation 20-Bond Municipal Bond Index		

As directed by the ERS, the asset basis for the date of depletion projection is the ERS’s net assets (the gross assets less the Pension Obligation Bond proceeds). On this basis, net assets were exhausted in the 2014-2015 fiscal year and no projection was needed to be performed as of June 30, 2016, as the tax-free municipal bond index applies in all years and is thus the single equivalent interest rate that is used as the discount rate in the determination of the Total Pension Liability. The actuarial report does not include any amounts from the AUC required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and if their financial condition does not improve in the near term.

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.

Changes in Net Pension Liability	Increase (Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balance as of June 30, 2015	\$32,669,162,000	(\$ 605,230,000)	\$33,337,434,000
Changes for the year:			
Service Cost	496,732,000		496,732,000
Interest on Total Pension Liability	1,230,843,000		1,230,843,000
Effect of Plan Changes	0		0
Effect of Economic/Demographic (Gains) or Losses	(252,405,000)		(252,405,000)
Effect of Assumptions Changes or Inputs	3,853,693,000		3,853,693,000
Benefit Payments	(1,565,152,000)	(1,565,152,000)	0
Administrative Expenses		(27,670,000)	27,670,000
Other Expenses		(32,761,000)	32,761,000
Costs of Bonds		(196,211,000)	196,211,000
Member Contributions		333,633,000	(333,633,000)
Net Investment Income		111,071,000	(111,071,000)
Employer Contributions		779,477,000	(779,477,000)
<b>Balance as of June 30, 2016</b>	<b>\$36,432,873,000</b>	<b>(\$ 1,265,885,000)</b>	<b>\$37,698,758,000</b>

continue

**6. PENSION PLAN – continuation**

ERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, ERS expects to continue using a discount rate net of administrative expenses for GASBS’s 67 and 68 calculations through at least the 2017-2018 fiscal year. ERS will continue to check the materiality of the difference in calculation until we have changed our methodology.

***Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate***

The following presents the Total Pension Liability, calculated using the discount rate, as well as what the Net Pension 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:

	<b>1% Decrease 1.85%</b>	<b>Current Discount Rate 2.85%</b>	<b>1% Increase 3.85%</b>
Total Pension Liability	\$41,973,101,000	\$36,432,873,000	\$31,922,005,000
Fiduciary Net Position	(1,265,885,000)	(1,265,885,000)	(1,265,885,000)
Net Pension Liability	\$43,238,986,000	\$37,698,758,000	\$33,187,890,000

**Fiscal Plan for Puerto Rico**

The Fiscal Plan for Puerto Rico was approved by the Oversight Board of PROMESA (see Note 9) on March 13, 2017. The approval was conditioned on the Puerto Rico government and the Board reaching an agreement to reduce benefit payments of the following systems by 10% in the aggregate:

- Puerto Rico Government Employees Retirement System
- Puerto Rico Judiciary Retirement System
- Puerto Rico Teachers Retirement System

The details of the reduction methodology, which will determine how the reductions impact each system, are not final at this time. A multi-year delay in implementation is also anticipated. These potential reductions are not reflected in the June 30, 2016 valuation. Also, note that the Fiscal Plan does not anticipate future payment of the Act 3-2013 AUC (shown earlier as \$776 million for fiscal year 2016-2017 and \$685 million per year for fiscal years 2017-2018 through 2032-2033) contained in current law. Rather, the Fiscal Plan anticipates that ERS will be funded on a pay-as-you-go basis once assets are exhausted.

**Pay-As-You-Go Funding**

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 in order to convey to the central government agencies, public corporations and municipalities the new implementation procedures to adopt, effective July 1, 2017, a new “pay-as-you-go” (Pay-Go) mechanism for the ERS.

Subsequently, on August 23, 2017, the Governor signed into law the “Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants” (Act No. 106), which reformed the Commonwealth Retirement Systems. Act. No. 106 terminated the previously existing pension programs for the ERS’s participants as of June 30, 2017. The members of the prior programs and new system members hired on and after July 1, 2017 are now enrolled in a new defined contributions program. Act No. 106 also established by law the Pay-Go mechanism for the payment of accumulated pension benefits and eliminated employers’ contributions and other analogous contributions. Approximately \$2 billion was allocated for the payment of Pay-Go benefits in each of the budgets for fiscal years 2018 and 2019.

continue

## 6. PENSION PLAN – continuation

Furthermore, Act No. 106 modified the ERS's governance. Under Act No. 106, the ERS' Board of Trustees was substituted with a new Retirement Board, which is currently responsible for governing all of the Commonwealth's Retirement Systems.

Act No. 106 also ordered a suspension of the ERS's loan programs and ordered a merger of the administrative structures of the retirement systems. At the Retirement Board's discretion, the servicing of the ERS's existing loan portfolio may be externalized. Pursuant to Act No. 106, the employees of the ERS that are not retained under the new administrative structure will be transferred to other public agencies in conformity with Act No. 8 of February 8, 2017.

At a basic level, ERS will need to hold some level of operating cash to account for any ongoing timing issues between receipt and disbursement of funds. The Pay-Go funding needed in a given year is the difference between actual contributions and actual disbursements:

- Contributions to ERS are primarily based on statutory percentage of payroll.
- Disbursements are comprised of benefit payments, administrative expenses, and Pension Obligation Bond debt service.

Contributions and disbursements will experience natural variation due to emerging demographic experience. Contributions and disbursements can 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 by ERS and the Commonwealth is determining what the process of ERS budgeting for "pay-go" funding will be. While the ERS can set an expected "pay-go" amount at the time of budgeting for an upcoming fiscal year, both actual contributions and disbursements can vary from expectations during the fiscal year.

- 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 thought 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, as updated on October 23, 2018, the Actuaries state: **"PRGERS net assets became negative in the 2014-2015 fiscal year. If the increasing Law 116-2011 employer contributions, the Supplementary Contribution under Act 3-2013, and the Additional Uniform Contribution under Act 32-2013 (as amended by Act 244-2014) are not paid in full on an annual basis, PRGERS will continue being rapidly disfunded and gross assets will be exhausted."**

The Employee's Retirement System of the Government of the Commonwealth of Puerto Rico provides additional information of the Defined Benefit Program and Hybrid Program. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Commonwealth. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.



## 7. OTHER POSTEMPLOYMENT BENEFITS (OPEB)

In addition to the pension benefits described in Note 20 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 Municipality 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 requires a systematic, accrual basis measurement and recognition of OPEB cost (expense) over a period that approximates employees' years of service and provides information about actuarial accrued liabilities associated with OPEB and whether and to what extent progress is being made in funding that plan. Annual postemployment benefits cost should equal the annual required contribution to the plans, calculated in accordance with certain parameters. These benefits are recorded as expenditures when paid in the General Fund of the Commonwealth of Puerto Rico.

The contribution requirement of ERS Medical Insurance Plan Contribution (MIPC) is established by Act No. 95 approved on June 29, 1963. 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 of Puerto Rico. Since this benefit is not funded in advance, the Annual Required Contribution (ARC) for this benefit has been calculated based on an assumed investment return rate of 3.00% based on the asset allocation on the Commonwealth's general assets that are used to pay this benefit.

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 Department with the audited schedules of employment allocations and OPEB amounts by employer as of June 30, 2017, 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 been omitted.

### **Christmas Bonus Benefits**

The Christmas Bonus was \$200 per retiree pursuant to Act No. 3 of April 4, 2013. This benefit is recorded as expenditures when paid in the General Fund of the Commonwealth of Puerto Rico.

## 8. CONTINGENCIES

### **A. Federal Awards**

In the normal course of operations, the Department participates in various federal grant agreements from year to year. The expenditures financed by grants are subject to program compliance audits by the grantor and passed-through agencies in order to assure compliance with grant requirements. If expenditures are disallowed due to noncompliance with grant program regulations, the Department may be required to reimburse the grantors for such expenditures.

The Department is also subject to audits performed by the Office of the Comptroller of Puerto Rico.

continue

**8. CONTINGENCIES – continuation**

***B. High-Risk Status***

On October 29, 2009, the Department was notified by the U.S. Environmental Protection Agency (EPA) of its status as high-risk grantee. This status was determined by the findings documented during an on-site review conducted by the EPA on June 2005 and pursuant to the EPA regulations at 40 CFR 31.12. As of June 30, 2019, the Department still has a high-risk status since they have not complied with all the special grant conditions.

***C. Litigation***

The Department is defendant in lawsuits arising in the normal course of governmental operations, principally from claims for alleged violation of civil rights and discrimination in employment practices. According to the laws of the Commonwealth of Puerto Rico, the Department is fully represented by the Puerto Rico Department of Justice in defense of all legal cases against the Department. Any claims with negative financial impact will be paid from the General Fund of the Commonwealth of Puerto Rico, with no effect on the budget or resources of the Department, except for the following case.

The Department was sued in 2004 by Vaquería Tres Monjitas and Suiza Dairy, Inc. The subject of this case was a request from the milk processing plants to adjust the price structure for their product which is regulated under Puerto Rico Laws and regulations. To resolve the subject matter, the Secretary of the Department signed on October 29, 2013 a Final Settlement Agreement and a Memorandum of Understanding. As part of the settlement, the Department will pay to the plaintiffs of this case the amount of \$170 million. The schedule of payment to cover aforementioned amount and is established by the respective legal document as follows:

- \$50 million during calendar year 2014 no later than December 31, 2014.
- \$15 million during calendar year 2015 no later than December 31, 2015.
- \$15 million during calendar year 2016 no later than December 31, 2016.
- \$15 million during calendar year 2017 no later than December 31, 2017.

Of these amounts the Commonwealth had been paid \$69.6 million up to June 2019.

The rest of the amount awarded through the settlement will be paid with an increase on the price of milk of 3 cents that will be assign on behalf of the plaintiffs. The increase of the price started in January 2017. The total amount will be paid in full by 2028.

The majority of the other legal claims are covered under PROMESA Tittle III coverage stay. A final determination on a legal claim dated September 2015, against the Department, requires a payment of \$17,000,000, but this determination is covered under the PROMESA Title III Stay.

**9. 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.

continue

**9. GOING CONCERN – PRIMARY GOVERNMENT – continuation**

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 filing 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 section 362 and 922, which are made applicable to Title III cases pursuant to PROMESA section 301(a). accordingly, upon the filing 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.

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.

continue

**9. GOING CONCERN – PRIMARY GOVERNMENT – continuation**

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 27, 2020 (see Note 10 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 States 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 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.

*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*

continue

## 9. GOING CONCERN – PRIMARY GOVERNMENT – continuation

- (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.

## 10. 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.<sup>1</sup> 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.

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.

continue

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

**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.

*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.

continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

*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;
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:**

continue

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- **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.

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.



**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

**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.

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 the Treasury Department, as well as a liquidity facility of up to \$185 million for municipalities suffering from revenue collection deferrals.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

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.

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

***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.

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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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:**
  - ⇒ Treasury Department: 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 & Housing: 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)

***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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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
- **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”.

continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

- **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
- 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.

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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 14, 20 and 22) but should ultimately consolidate permit requests, filing for incentives and annual reporting on these Acts.

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

continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

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.

continue



**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.
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 sustainable 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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

**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:

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.

continue

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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).<sup>196,197</sup> 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.

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.

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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.

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 (Law 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).

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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 enshrined 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. 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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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:

- **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
- **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
  - 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

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- Establish budgetary priorities-namely, effective expenditure controls and Government-wide procurement reforms

- **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.

- **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:**

- 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.**

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

- 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 expenditures<sup>240</sup> (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

***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”).

continue



**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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 reverts 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.<sup>256</sup> 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.

**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 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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

**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.
- 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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

**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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

***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.

continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

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 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 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 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 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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

**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.

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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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**

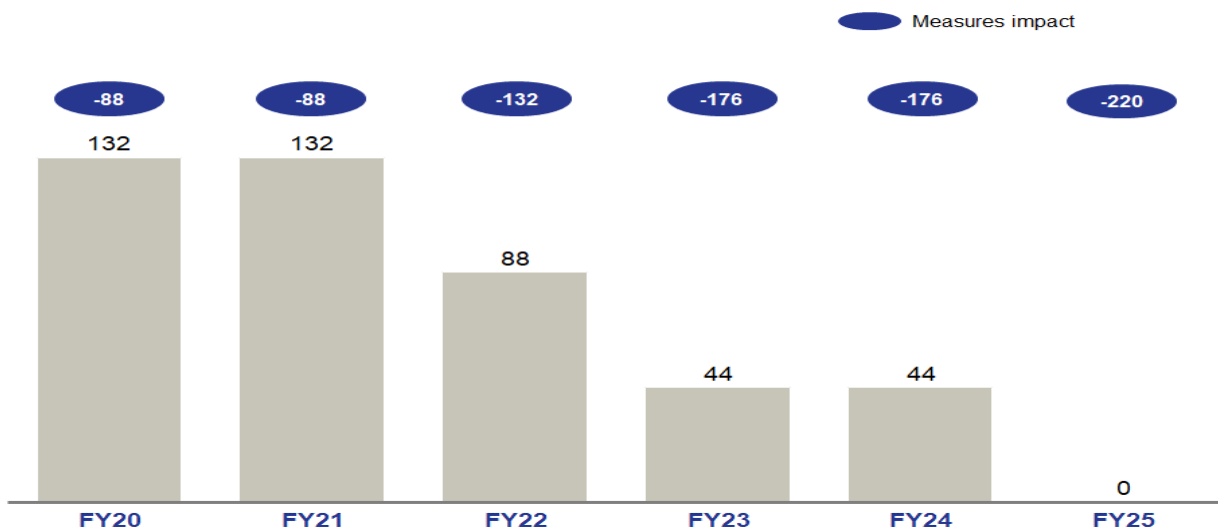
The onset of the COVID-19 pandemic resulted in the deferral of the personal property tax return due date as an emergency measure enacted by the Government. This extension has created a short-term liquidity challenge for MRCC and the municipalities for the remainder of FY2020 (May and June) and the first 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.

**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.

Summary of appropriation (net of measures), \$M



continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

**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.

***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 106-2017**

With Act 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).

continue



10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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 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.

**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**

Monthly benefit amount	ERS		TRS		JRS	
	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.

continue

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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

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

10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- 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.

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.

**10. PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation**

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.

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).

**11. RELATED PARTY TRANSACTIONS**

The Department has the following transactions with governmental units:

- ◆ The Department paid to Puerto Rico Electric Power Authority the amount of \$389,194 for services provided during the fiscal year ended June 30, 2019.
- ◆ The Department paid to Puerto Rico Aqueduct and Sewer Authority the amount of \$3,000 for services provided during the fiscal year ended June 30, 2019.
- ◆ The Department paid to Puerto Rico Highway Authority the amount of \$11,152 for tolls used during the fiscal year ended June 30, 2019.
- ◆ The Department paid to Puerto Rico General Services Administration the amount of \$58,973 for gasoline, diesel, and motor vehicles maintenance services provided during the fiscal year ended June 30, 2019.

**12. SUBSEQUENT EVENT**

The Department has evaluated subsequent events through September 29, 2020, the date which the financial statement was available to be issued.

**PROMESA**

The Financial Oversight and Management Board for Puerto Rico welcomes the decision by Judge Laura Taylor Swain of the U.S. District Court for the District of Puerto Rico on April 15, 2020 to nullify the Puerto Rico "Act for Reductions of the Administrative Burdens of the Municipalities" (Law No. 29-2019). Judge Swain granted the Oversight Board's requests for summary judgment on several grounds, declared Law No. 29 unenforceable, and permanently enjoined the Puerto Rico Government from implementing and enforcing it. In addition, the Court concluded that joint resolutions which reprogrammed prior year appropriations and were not certified by the Oversight Board violated PROMESA. Accordingly, Municipalities and the central government have to each budget their own payments for their retirees responsibly and realistically.

The Oversight Board welcomes the U.S. Supreme Court's unanimous decision today that will allow the Members and Oversight Board to continue their work under PROMESA.

## 12. SUBSEQUENT EVENTS – continuation

The Supreme Court confirmed that PROMESA established the Oversight Board as an entity within the Government of Puerto Rico and that the congressionally mandated process for selecting members of the Oversight Board does not violate the Constitution's Appointments Clause.

PROMESA's appointment process has established a bipartisan Oversight Board, ensuring balanced decisions to help Puerto Rico recover and prosper. The Members of the Oversight Board have an important mandate to help Puerto Rico recover from an unsustainable debt burden and decades of fiscal mismanagement. The Oversight Board has been renegotiating Puerto Rico's debt and has been steadily working towards instituting long term fiscal planning and balanced budgeting.

Then, approved the 6<sup>th</sup> Fiscal Plan on May 9, 2019. The scope of the Fiscal Plan is described in that Note.

On September 27, 2019, the Oversight Board – as representative of the Commonwealth, the System, and PBA in their respective Title III cases – filed its initial joint Title III Plan of Adjustment for the Commonwealth, the System and PBA [ECF No. 8765] (the Initial Plan) along with a disclosure statement related thereto [ECF No. 8765] (the Initial Disclosure Statement). On February 28, 2020, the Oversight Board filed its *Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico, et al.* [ECF No. 11946] (the Amended Plan) and an amended disclosure statement related thereto [ECF No. 11947] (the Amended Disclosure Statement), which revised the Initial Plan to conform to the PSA.

The Amended Plan and Amended Disclosure Statement do not reflect the potential impact from the on-going outbreak of a respiratory illness caused by a novel (new) coronavirus known as COVID-19 first identified in Wuhan, Hubei Province, China. As a result, on March 23, 2020, the Oversight Board filed an urgent motion requesting to adjourn consideration of the Amended Disclosure Statement – currently scheduled for June 3 and June 4, 2020 – until further notice. The Amended Plan and Amended Disclosure Statement remain subject to future amendments, particularly given the potential economic impact of COVID-19, and Title III Court approval, and it is not certain that the Title III Court will ultimately confirm the Amended Plan. For further information, please refer to the publicly available Amended Plan and Amended Disclosure Statement, available at <https://cases.primeclerk.com/puertorico/home-Docketinfo>.

### Catastrophe Events

Since December 28, 2019, the southwest portion of the island was impacted by a series of earthquakes, with the most powerful, a 6.4, on January 7, 2020.

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout the United States and Puerto Rico. As a result, and in response to the executive orders of the President of the United States and the Governor of the Commonwealth of Puerto Rico, executive orders: Families First Coronavirus Response Act ("FFCRA"), and Implementation of the Necessary Closings of Private and Government Operations to Combat the Effects and Spread of COVID-19 in the Island of Puerto Rico, issued on March 18, 2020 and March 15, 2020, respectively, and their amendments; we have temporarily closed our operating locations, reduced operating hours, and have seen a reduction in citizen traffic, all resulting in a negative impact to Puerto Rico's government and private operations. While the disruption is currently expected to be temporary, there is uncertainty around the duration. Therefore, while we expect this matter to negatively impact our results of operations and financial position, the related financial impact cannot be reasonably estimated at this time.

**12. SUBSEQUENT EVENTS** – continuation

**Former Governor Rosselló’s Resignation and Government Transition under Governor Wanda Vázquez Garced**

On July 24, 2019, then-Governor Ricardo Rosselló Nevares announced his resignation as Governor of the Commonwealth effective August 2, 2019 at 5pm Atlantic Standard Time. Before his resignation became effective, then-Governor Rosselló appointed Former Resident Commissioner Pedro Pierluisi as Secretary of State. After being confirmed by the House of Representatives (but not the Senate), Mr. Pierluisi was sworn in as acting Governor. On August 7, 2019, the Puerto Rico Supreme Court unanimously determined that Mr. Pierluisi was illegally sworn into office as Governor. As a result, Justice Secretary Wanda Vázquez Garced was sworn in as Governor on August 7, 2019 to complete former Governor Rosselló’s term through 2020 and, as of the date of this financial statement, currently serves as the Governor of Puerto Rico.

**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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COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF AGRICULTURE

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

<i>Federal Grantor/Pass-Through Grantor/Program or Cluster Title</i>	<i>Federal CFDA Number</i>	<i>Pass-Trough Entity Identification Number</i>	<i>Pass-Trough To Subrecipients</i>	<i>Total Federal Expenditures</i>
<b>U.S. DEPARTMENT OF AGRICULTURE:</b>				
Direct Programs:				
Plant and Animal Disease, Pest Control and Animal Care	10.025		\$ -	\$ 182,240
Inspection Grading and Standardization	10.162		-	282,628
Environmental Quality Incentives Program	10.912		-	9,900
<b>Total U.S. Department of Agriculture</b>			-	<u>474,768</u>
<b>U.S. ENVIROMENTAL PROTECTION AGENCY:</b>				
Direct Programs:				
Performance Partnership Grants	66.605		-	227,312
<b>Total U.S. Environmental Protection Agency</b>			-	<u>227,312</u>
<b>U.S DEPARTMENT OF HOMELAND SECURITY:</b>				
Direct Programs:				
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036		-	50,648
<b>Total U.S. Department of Homeland Security</b>			-	<u>50,648</u>
<b>Total Expenditures of Federal Awards</b>			<u>\$ -</u>	<u>\$ 752,728</u>

The accompanying Notes to Schedule of Expenditures of Federal Awards are an integral part of this schedule.

**1. REPORTING ENTITY**

The Puerto Rico Department of Agriculture of the Commonwealth of Puerto Rico (Department), was originally created under the dispositions of the Jones Act of the United States Congress on March 2, 1917.

**2. BASIS OF PRESENTATION**

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal award activities of the Department of Agriculture of the Commonwealth of Puerto Rico (Department) 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 Department, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Department.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

- A. Expenditures reported on the Schedule are reported on the cash basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, 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.
- D. The Department has not elected to use the 10 percent de minimis indirect cost rate allowed under the Uniform Guidance.

**4. SCHEDULE NOT IN AGREEMENT WITH OTHER FEDERAL AWARD REPORTING**

The information included in the Schedule may not fully agree with other Federal award reports submitted directly to Federal granting agencies.

**5. 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.

**6. LATENESS OF SINGLE AUDIT REPORTING PACKAGE**

The Single Audit reporting package, as defined and required in 2 CFR 200 for fiscal year ended June 30, 2019, could not be submitted in a timely manner because of the effects of the Novel Coronavirus COVID-19. As further discussed in the Department's Notes to the Financial Statement included in its audited financial statement for the same year, the Department's activities were affected by the Executive Order issued by the Governor of Puerto Rico, and subsequently a waiver was granted by the OMB through the issuance of the memorandum M-20-17.

**7. RELATIONSHIP TO STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND NET CHANGES – GOVERNMENTAL FUND**

Expenditures of federal awards are reported in the Department's *Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Fund* in the Federal Grants Fund \$752,728.

Expenditures recognized in the Federal Grants Fund included expenditures in the amount of \$1,457,577 related to Federal funding from the Disaster Grants – Public Assistance (CFDA 97.036), which were granted to the Puerto Rico Agriculture Enterprise Development Administration (ADEA). Because ADEA did not have a bank account within the Puerto Rico Treasury Department, all funding claimed to FEMA were transferred through the Department. ADEA is responsible for all reporting and compliance requirements related to this amount claimed. Expenditures were reported in the Department's *Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Fund*, but are not part of the Schedule of Expenditures of Federal Awards of the Department.

**END OF NOTES**

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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 STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Honorable Carlos A. Flores Ortega, Secretary  
Department of Agriculture 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 statement of the **Department of Agriculture of the Commonwealth of Puerto Rico (Department)**, as of and for the fiscal year ended June 30, 2019, and the related notes to financial statement, which collectively comprise the **Department's** financial statement, and have issued our report thereon dated September 29, 2020.

**Going Concern**

The **Department** is part of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statement includes an emphasis-of-matter paragraph describing conditions, discussed in Note 10 to the basic financial statement, 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 financial statement, we considered the **Department'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 financial statement, but not for the purpose of expressing an opinion on the effectiveness of the **Department's** internal control. Accordingly, we do not express an opinion on the effectiveness of the **Department's** internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weakness or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

**To the Honorable Carlos A. Flores Ortega, Secretary**

**Department of Agriculture of the  
Commonwealth of Puerto Rico**

Page 2

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 the **Department's** financial statement will not be prevented, or detected and corrected on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as items 2019-001 through 2019-006 to be material weaknesses.

**Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the **Department's** financial statement 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Questioned Costs as items 2019-001 through 2019-006.

**Department's Response to Findings**

The **Department's** response to the findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. The **Department's** response was not subjected to the auditing procedures applied in the audit of the financial statement and, accordingly, we express no opinion on it.

**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 the **Department'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  
September 29, 2020

Stamp No. E413106 of the Puerto Rico Society of Certified  
Public Accountants was affixed to the original report.



## INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Honorable Carlos A. Flores Ortega, Secretary  
Department of Agriculture of the  
Commonwealth of Puerto Rico  
San Juan, Puerto Rico

### Report on Compliance for Each Major Federal Program

We have audited the **Department of Agriculture of the Commonwealth of Puerto Rico (Department)**'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 the **Department**'s major Federal programs for the fiscal year ended June 30, 2019. The **Department**'s major Federal programs are identified in the Summary of Auditors' Result Section of the accompanying Schedule of Findings and Questioned Costs.

### **Going Concern**

The **Department** is an instrumentality of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statement includes an emphasis-of-matter paragraph describing conditions, discussed in Note 10 to the basic financial statement, 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 the **Department**'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 the **Department**'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

**INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

To the Honorable Carlos A. Flores Ortega, Secretary  
 Department of Agriculture of the  
 Commonwealth of Puerto Rico

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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 the **Department’s** compliance.

***Basis for Qualified Opinion (See the following Table)***

As described in the accompanying Schedule of Findings and Questioned Costs, the **Department** did not comply with requirement regarding the following:

Finding Number	CFDA Number	Program (or Cluster) Name	Compliance Requirement
2019-007	10.025	Plant and Animal Disease, Pest Control and Animal Care	Allowable Costs/Cost Principles
2019-008	66.605	Performance Partnership Grants	Allowable Costs/Cost Principles
2019-009	10.025 66.605	Plant and Animal Disease, Pest Control and Animal Care / Performance Partnership Grants	Matching, Level of Effort, Earmarking
2019-010	10.025	Plant and Animal Disease, Pest Control and Animal Care	Reporting
2019-011	66.605	Performance Partnership Grants	Reporting
2019-012	10.025 66.605	Plant and Animal Disease, Pest Control and Animal Care / Performance Partnership Grants	Reporting

Compliance with such requirements is necessary, in our opinion, for the **Department** to comply with the requirements applicable to those programs.

***Qualified Opinion (See the above Table)***

In our opinion, except for the noncompliance described in the “Basis for Qualified Opinion” paragraph, the **Department** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on the major Federal programs described in the above table for the fiscal year ended June 30, 2019.

***Other Matters***

The **Department’s** response to the noncompliance finding identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. The **Department’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 the **Department** 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 the **Department’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 the **Department’s** internal control over compliance.



**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND ON  
INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE**

**To the Honorable Carlos A. Flores Ortega, Secretary  
Department of Agriculture of the  
Commonwealth of Puerto Rico**

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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 deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 2019-007 through 2019-012 to be material weaknesses.*

The **Department's** response to the internal control over compliance findings identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs and Corrective Action Plan. The **Department'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 Díaz-Martínez, PSC  
Certified Public Accountants & Consultants  
License Number 12, expires on December 1, 2022

Caguas, Puerto Rico  
September 29, 2020

Stamp No. E413107 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 AUDITORS' RESULTS

**Financial Statements**

Type of auditor's report issued:  Unmodified Opinion  
Modified:  Qualified Opinion  
 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 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  
 Qualified Opinion  
     ▪ Plant and Animal Disease, Pest Control and Animal Care  
     ▪ Performance Partnership Grants  
 Adverse Opinion  Disclaimer Opinion

Any audit findings 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
10.025	Plant and Animal Disease, Pest Control and Animal Care
66.605	Performance Partnership Grants

Dollar threshold used to distinguish between Type A and Type B Programs: \$750,000

Auditee qualified as low-risk auditee?  Yes  No

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-001 (See Finding Reference Number 2019-007)
<b>FEDERAL PROGRAM</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	In accordance with 2 CFR Section 200.403 which states that costs must meet the following general criteria in order to be allowable under Federal awards: (c) be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity, (d) be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost and (g) be adequately documented. In addition, the 2 CFR 200.430 states that Standards for Documentation of Personnel Expenses (1) charges to Federal awards for salaries and wages must be based on records that accurately reflect the work performed. These records must: (i) be supported by a system of internal control which provides reasonable assurance that the charges are accurate, allowable, and properly allocated and (ii) be incorporated into the official records of the non-Federal entity.
<b>CONDITION</b>	As part of our audit procedures for allowable cost we requested a list of employees with their time sheets and we noted that the time reports does not specified the awards to be charged for the payroll expenditure.
<b>CORRECTIVE ACTION PLAN</b>	The Finance Department will correct what has already been done from the PRIFAS modules. Subsequently, the Grant manager will send the data of the attendance or changes of the personnel to the payroll area so that from there the report of their changes and awards corresponding to the payroll expenses can be made.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-002 (See Finding Reference Number 2019-008)
<b>FEDERAL PROGRAM</b>	PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	During our audit procedures of internal controls and compliance for allowable costs we found the following deficiencies:  (a) we requested a list of employees with their time sheets that reflects the actual hours worked daily and their fringe benefits and we noted that the time reports do not specified the awards to be charged for the payroll expenditure. (b) in the accounting system PRIFAS the employees are identified by an award that is incorrect. (c) from the list of employees requested on (a), we noticed that two of the employees are in a pre-retirement plan since January 1, 2017, these costs were charged to PRIFAS to the Federal program when they should have been charged to the operational fund of the <b>Department</b> .
<b>CORRECTIVE ACTION PLAN</b>	A wage adjustment will be made to correct awards in the RHUM System. The payroll area will validate the information obtained by the Grant Manager, the timesheets, and will update the severance expenses. The Grant Manager must inform the payroll and finance section of any changes to the Grant in writing.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-003 (See Finding Reference Number 2019-009)
<b>FEDERAL PROGRAMS</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	<p>In accordance with 2 CFR Section 200.306 which states that (b) for all Federal awards, any shared costs or matching funds and all contributions, including cash and third party in-kind contributions, must be accepted as part of the non-Federal entity's cost sharing or matching when such contributions meet all of the following criteria:</p> <ol style="list-style-type: none"><li>(1) Are verifiable from the non-Federal entity's records;</li><li>(2) Are not included as contributions for any other Federal award;</li><li>(3) Are necessary and reasonable for accomplishment of project or program objectives; (4) Are allowable under Subpart E – Cost Principles of this part;</li><li>(4) Are not paid by the Federal Government under another Federal award, except where the Federal statute authorizing a program specifically provides that Federal funds made available for such program can be applied to matching or cost sharing requirements of other Federal programs;</li><li>(5) Are provided for in the approved budget when required by the Federal awarding agency; and</li><li>(6) Conform to other provisions of this part, as applicable.</li></ol>
<b>CONDITION</b>	As part of our audit procedures we requested the Grant Award to read the requirements of the program and we noted that the agreement have an approved budget that indicated the cost share of federal funds and state funds. Therefore, we requested to the <b>Department</b> to identify the matching allocation in the accounting system PRIFA, but no information was received to evidence with the program compliance requirements.
<b>CORRECTIVE ACTION PLAN</b>	The Finance Director will verify the funds and balance of each Grant at the beginning of each year. Therefore, when a new Federal income is received, the PRIFAS system will be informed were the funds are deposited. We will work with the system to verify if its use can be maximized.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director



SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-004 (See Finding Reference Number 2019-010)
<b>FEDERAL PROGRAM</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not indicated that were prepared under accrual basis of accounting, although, the expenditures reported were in cash basis. In addition, the expenditures reported for salaries, were based on a manual calculation of hours worked times rate per hour, instead of actual salaries paid.
<b>CORRECTIVE ACTION PLAN</b>	SF-425 reports are already being made in Cash-Basis.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-005 (See Finding Reference Number 2019-011)
<b>FEDERAL PROGRAM</b>	PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>AWARD NUMBER</b>	BG 96262901
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	<b>MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE</b>
<b>CRITERIA</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not prepared.
<b>CORRECTIVE ACTION PLAN</b>	SF-425 are being updated and will be sent quarterly to EPA.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION II – FINANCIAL STATEMENT FINDINGS

<b>FINDING REFERENCE NUMBER</b>	2019-006 (See Finding Reference Number 2019-012)
<b>FEDERAL PROGRAMS</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>TYPE OF FINDING</b>	<b>MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS</b>
<b>CRITERIA</b>	<p>2 CFR §200.510 Financial Statements, (b) states that the auditee must prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended. At a minimum, the schedule must:</p> <ol style="list-style-type: none"><li>(1) List individual Federal programs by Federal agency.</li><li>(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included.</li><li>(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.</li><li>(4) Include the total amount provided to subrecipients from each Federal program.</li><li>(5) For loan or loan guarantee programs identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.</li></ol>
<b>CONDITION</b>	During our audit procedures of the SEFA prepared by the <b>Department</b> we identified material misstatements related to the programs reported in the schedule. Two Federal programs were reported with the incorrect CFDA number in the SEFA; adjustments were proposed in order to reconcile the information with the financial statement.
<b>CORRECTIVE ACTION PLAN</b>	The Grant Manager keeps a record of the different grants in which the amount of funds, employee-related expenses, time worked and other expenses are included. The Finance Office will make the adjustments and changes to the data of the different grants in both PRIFAS and RHUM.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-007 (See Finding Reference Number 2019-001)
<b>FEDERAL PROGRAM</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE
<b>AWARD NUMBER</b>	AP18PPQFO000C081; AP18PPQFO000C082
<b>COMPLIANCE REQUIREMENT</b>	ALLOWABLE COSTS/COST PRINCIPLES
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	In accordance with 2 CFR Section 200.403 which states that costs must meet the following general criteria in order to be allowable under Federal awards: (c) be consistent with policies and procedures that apply uniformly to both federally-financed and other activities of the non-Federal entity, (d) be accorded consistent treatment. A cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost and (g) be adequately documented. In addition, the 2 CFR 200.430 states that Standards for Documentation of Personnel Expenses (1) charges to Federal awards for salaries and wages must be based on records that accurately reflect the work performed. These records must: (i) be supported by a system of internal control which provides reasonable assurance that the charges are accurate, allowable, and properly allocated and (ii) be incorporated into the official records of the non-Federal entity.
<b>CONDITION</b>	As part of our audit procedures for allowable cost we requested a list of employees with their time sheets and we noted that the time reports does not specified the awards to be charged for the payroll expenditure.
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem.
<b>EFFECT</b>	The <b>Department</b> is not in compliance with the requirements of documentation, related to time and effort of payroll reporting.
<b>CAUSE</b>	The <b>Department</b> does not have internal control procedures, in order to properly document the time and effort of each employee, for which their salary will be paid by Federal awards.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with this allowable cost requirement.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**FINDING REFERENCE NUMBER** 2019-007 (See Finding Reference Number 2019-001) – continuation

**VIEWS OF RESPONSIBLE  
OFFICIALS AND PLANNED  
CORRECTIVE ACTION**

It will be required a new section will be established within the finance department of the Agriculture department where specific personnel will be in charge to work with the federal agreements. These people will have access to PRIFAS and any accounting system necessary for federal accounts. If necessary, training will be requested to carry out these tasks. With this implementation, outlined in this report can be met. The Finance Department will correct what has already been done from the PRIFAS and RHUM modules. Subsequently, the manager of the Grant will send the data of the attendance or changes of the personnel to the payroll area so that from there the report of its changes and awards corresponding to the payroll expenses can be made.

**IMPLEMENTATION DATE**

FY2020-21

**RESPONSIBLE PERSON**

Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-008 (See Finding Reference Number 2019-002)
<b>FEDERAL PROGRAM</b>	PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>AWARD NUMBER</b>	BG 96262901
<b>COMPLIANCE REQUIREMENT</b>	ALLOWABLE COSTS/COST PRINCIPLES
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	<p>During our audit procedures of internal controls and compliance for allowable costs we found the following deficiencies:</p> <ul style="list-style-type: none"> <li>(a) we requested a list of employees with their time sheets that reflects the actual hours worked daily and their fringe benefits and we noted that the time reports do not specified the awards to be charged for the payroll expenditure.</li> <li>(b) in the accounting system PRIFAS the employees are identified by an award that is incorrect.</li> <li>(c) from the list of employees requested on (a), we noticed that two of the employees are in a pre-retirement plan since January 1, 2017, these costs were charged to PRIFAS to the Federal program when they should have been charged to the operational fund of the <b>Department</b>.</li> </ul>
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem.
<b>EFFECT</b>	The <b>Department</b> is not in compliance with the requirements of documentation, related to time and effort of payroll reporting. In addition, the <b>Department</b> is recording payroll expenditures and the related benefits in an incorrect account in their accounting system.
<b>CAUSE</b>	The <b>Department</b> does not have internal control procedures, in order to properly document the time and effort of each employee, for which their salary will be paid by federal awards. In addition, the <b>Department</b> does not verify the correct posting of each payroll paid on their accounting system.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with this allowable cost requirement. In addition, proper review and authorization in transactions to be reported in the accounting system should be in place and periodically monitored.

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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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**FINDING REFERENCE NUMBER**      2019-008 (See Finding Reference Number 2019-002) – continuation

**VIEWS OF RESPONSIBLE  
OFFICIALS AND PLANNED  
CORRECTIVE ACTION**

The Finance Department will correct what has already been done from the PRIFAS and RHUM modules. Subsequently, the Grant manager will send the data of the attendance or changes of the personnel to the payroll area so that from there the report of their changes and awards corresponding to the payroll expenses can be made. Adjustment are already being made in PRIFAS and verification will continue to be followed for future changes.

**IMPLEMENTATION DATE**                      FY2020-21

**RESPONSIBLE PERSON**                      Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-009 (See Finding Reference Number 2019-003)
<b>FEDERAL PROGRAMS</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>AWARD NUMBER</b>	AP18PPQFO000C081; AP18PPQFO000C082; BG 96262901
<b>COMPLIANCE REQUIREMENT</b>	MATCHING, LEVEL OF EFFORT, EARMARKING
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	<p>In accordance with 2 CFR Section 200.306 which states that (b) for all Federal awards, any shared costs or matching funds and all contributions, including cash and third party in-kind contributions, must be accepted as part of the non-Federal entity's cost sharing or matching when such contributions meet all of the following criteria:</p> <ol style="list-style-type: none"> <li>(1) Are verifiable from the non-Federal entity's records;</li> <li>(2) Are not included as contributions for any other Federal award;</li> <li>(3) Are necessary and reasonable for accomplishment of project or program objectives; (4) Are allowable under Subpart E – Cost Principles of this part;</li> <li>(4) Are not paid by the Federal Government under another Federal award, except where the Federal statute authorizing a program specifically provides that Federal funds made available for such program can be applied to matching or cost sharing requirements of other Federal programs;</li> <li>(5) Are provided for in the approved budget when required by the Federal awarding agency; and</li> <li>(6) Conform to other provisions of this part, as applicable.</li> </ol>
<b>CONDITION</b>	As part of our audit procedures we requested the Grant Award to read the requirements of the program and we noted that the agreement have an approved budget that indicated the cost share of federal funds and state funds. Therefore, we requested to the <b>Department</b> to identify the matching allocation in the accounting system PRIFA, but no information was received to evidence with the program compliance requirements.
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem.
<b>EFFECT</b>	The <b>Department</b> is not in compliance with the requirements of documentation, related to the matching requirement.
<b>CAUSE</b>	The <b>Department</b> does not have internal control procedures, in order to properly identify and document the matching amount required by the award document.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with this matching requirement. In addition, proper review and authorization in transactions to be reported in the accounting system should be in place and periodically monitored.

continue



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SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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**FINDING REFERENCE NUMBER**      2019-009 (See Finding Reference Number 2019-003) – continuation

**VIEWS OF RESPONSIBLE  
OFFICIALS AND PLANNED  
CORRECTIVE ACTION**

All grants will be awarded their allocations and support with which we determine and validate them.

**IMPLEMENTATION DATE**

FY2020-21

**RESPONSIBLE PERSON**

Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-010 (See Finding Reference Number 2019-004)
<b>FEDERAL PROGRAM</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE
<b>AWARD NUMBER</b>	AP18PPQFO000C081; AP18PPQFO000C082, AP18VSSPRS00C115
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not indicated that were prepared under accrual basis of accounting, although, the expenditures reported were in cash basis. In addition, the expenditures reported for salaries, were based on a manual calculation of hours worked times rate per hour, instead of actual salaries paid.
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem, the <b>Department</b> did not have an adequate internal controls to verify the required information before the submitting of the report. The personnel in charge doesn't have access to PRIFAS (accounting system) and also does not have the adequate training to comply with the reporting requirements.
<b>EFFECT</b>	The <b>Department</b> did not have proper accounting records and internal controls to allow them to maintain complete and accurate information to detect and correct accounting errors in a timely manner.
<b>CAUSE</b>	The <b>Department</b> does not have adequate internal controls in order to properly document and review the manual calculations with the accounting system.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with this reporting requirement.
<b>VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTION</b>	To carry out the SF-425 report, the GL-200 and RHUM system will be used, which are detailed by employees and by individual biweekly transactions.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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**FINDING REFERENCE NUMBER**      2019-010 (See Finding Reference Number 2019-004) – continuation

**IMPLEMENTATION DATE**              FY2020-21

**RESPONSIBLE PERSON**                Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-011 (See Finding Reference Number 2019-005)
<b>FEDERAL PROGRAM</b>	PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>AWARD NUMBER</b>	BG 96262901
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	MATERIAL WEAKNESS AND MATERIAL NONCOMPLIANCE
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	In accordance with 2 CFR Section 200.302 which states that (a) each state must expend and account for the Federal award in accordance with state laws and procedures for expending and accounting for the state's own funds. In addition, the state's and the other non-Federal entity's financial management systems, including records documenting compliance with Federal statutes, regulations, and the terms and conditions of the Federal award, must be sufficient to permit the preparation of reports required by general and program-specific terms and conditions; and the tracing of funds to a level of expenditures adequate to establish that such funds have been used according to the Federal statutes, regulations, and the terms and conditions of the Federal award.
<b>CONDITION</b>	As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not prepared.
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem.
<b>EFFECT</b>	There is no report that complies with the Grant Award and the funds granted by the agency may be affected.
<b>CAUSE</b>	The <b>Department</b> has not designated a person to prepare the required reports by the Federal program.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with this reporting requirement.
<b>VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTION</b>	The GL-200 and RHUM system will be analyzed and detailed so that the allocations are more precise and reliable. We will work in coordination with Grant Manager and the Payroll Office giving writing knowledge in Finance Department.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

<b>FINDING REFERENCE NUMBER</b>	2019-012 (See Finding Reference Number 2019-006)
<b>FEDERAL PROGRAMS</b>	PLANT AND ANIMAL DISEASE, PEST CONTROL AND ANIMAL CARE (CFDA 10.025) U.S. DEPARTMENT OF AGRICULTURE PERFORMANCE PARTNERSHIP GRANTS (CFDA 66.605) U.S. ENVIRONMENTAL PROTECTION AGENCY (EPA)
<b>AWARD NUMBER</b>	AP18PPQFO000C081; AP18PPQFO000C082; BG 96262901
<b>COMPLIANCE REQUIREMENT</b>	REPORTING
<b>TYPE OF FINDING</b>	MATERIAL NONCOMPLIANCE AND MATERIAL WEAKNESS
<b>CRITERIA OR SPECIFIC REQUIREMENT</b>	<p>2 CFR §200.510 Financial Statements, (b) states that the auditee must prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended. At a minimum, the schedule must:</p> <ol style="list-style-type: none"> <li>(1) List individual Federal programs by Federal agency.</li> <li>(2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included.</li> <li>(3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available.</li> <li>(4) Include the total amount provided to subrecipients from each Federal program.</li> <li>(5) For loan or loan guarantee programs identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.</li> </ol>
<b>CONDITION</b>	During our audit procedures of the SEFA prepared by the <b>Department</b> we identified material misstatements related to the programs reported in the schedule. Two Federal programs were reported with the incorrect CFDA number in the SEFA; adjustments were proposed in order to reconcile the information with the financial statement.
<b>QUESTIONED COSTS</b>	Not determined
<b>INFORMATION TO PROVIDE PROPER PERSPECTIVE</b>	This is a Systemic problem, the <b>Department</b> did not have proper accounting records and internal controls to allow them to maintain complete and accurate information to detect and correct accounting errors in a timely manner. We send a letter to the U.S. Environmental Protection Agency (EPA) in order to confirm the grant award available and they explained to us that in fact the award EE00222233 ceased on 2/28/2018 and that the remaining enforcement funds in EE00222233, combined with pesticide program funding, were rolled into a Performance Partnership Grant (PPG) BG 96262901 with a project period of 10/01/2017 to 09/30/2020. Expenditures from 7/1/2018 to 6/30/2019 would have been incurred under the PPG (CFDA Number 66.605). In addition, when we evaluated the expenditures of the Plant and Animal Disease, Pest Control, and Animal Care Program, we noticed that \$107,303.82 of the expenditures incurred were reported in the incorrect CFDA number.
<b>EFFECT</b>	Submitted reports, if any, can have incorrect information and it can affect the funds provided by the Federal agency.

SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

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<b>FINDING REFERENCE NUMBER</b>	2019-012 (See Finding Reference Number 2019-006) – continuation
<b>CAUSE</b>	The <b>Department</b> did not have adequate internal controls in order to properly present Federal expenditures with the applicable CFDA number in the SEFA.
<b>IDENTIFICATION AS A REPEAT FINDING</b>	N/A
<b>RECOMMENDATION</b>	We recommend management to implement internal controls over financial reporting in order to assure compliance with the applicable requirements and regulations.
<b>VIEWS OF RESPONSIBLE OFFICIALS AND PLANNED CORRECTIVE ACTION</b>	A correct accounting record will be established. The information that is entered into the system related to federal spending will be verified in more detail. In this way the information provided in the SEFA will be more accurate.
<b>IMPLEMENTATION DATE</b>	FY2020-21
<b>RESPONSIBLE PERSON</b>	Mrs. Ivelisse Santaliz – Finance Director

**END OF SCHEDULE**

(1) Audit Findings that have been Fully Corrected:

NONE

(2) Audit Findings not Corrected or Partially Corrected:

NONE

(3) Corrective action taken is significantly different from corrective action previously reported:

NONE

(4) Audit findings is no longer valid:

NONE

END OF SCHEDULE



GOBIERNO DE PUERTO RICO

Departamento de Agricultura

FINDING NUMBER	COMPLIANCE SECTION	AUDITOR'S DESCRIPTION	AUDITOR'S RECOMMENDATION	CORRECTIVE ACTION	LEAD PERSONS ACCOUNTABLE FOR ACTION ITEM COMPLETION	DELIVERABLE	EVIDENCE INCLUDED YES/NO	TARGET COMPLETION DATE
2019-001 (See Finding Reference Number 2019-007)		As part of our audit procedures for allowable cost we requested a list of employees with their time sheets and we noted that the time reports does not specified the awards to be charged for the payroll expenditure.		The Finance Department will correct what has already been done from the PRIFAS and RHUM modules. Subsequently, the Grant manager will send the data of the attendance or changes of the personnel to the payroll area so that from there the report of their times with their changes and awards corresponding to the payroll expenses can be made.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-002 (See Finding Reference Number 2019-008)		During our audit procedures of internal controls and compliance for allowable costs we found the following deficiencies: (a) we requested a list of employees with their time sheets that reflects the actual hours worked daily and their fringe benefits and we noted that the time reports do not specified the awards to be charged for the payroll expenditure. (b) in the accounting system PRIFAS the employees are identified by an award that is incorrect. (c) from the list of employees requested on (a), we noticed that two of the employees are in a pre-retirement plan since January 1, 2017, these costs were charged to PRIFAS to the Federal program when they should have been charged to the operational fund of the Department.		A wage adjustment will be made to incorrect awards in the RHUM System. The payroll area will validate the information obtained by the Grant Manager, the timesheets, and will update the severance expenses. The Grant Manager must inform the payroll and finance section of any changes to the Grant in writing.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-003 (See Finding Reference Number 2019-009)		As part of our audit procedures we requested the Grant Award to read the requirements of the program and we noted that the agreement has an approved budget that indicated the cost share of federal funds and state funds. Therefore, we requested to the Department to identify the matching allocation in the accounting system PRIFA, but no information was received to evidence with the program compliance requirements.		The Finance Director will verify the funds and balance of each Grant at the beginning of each year. Therefore, when a new federal income is received, the PRIFAS system will be informed were the funds are deposited. We will work with the system to verify if its use can be maximized.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-004 (See Finding Reference Number 2019-010)		As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not indicated that were prepared under accrual basis of accounting, although, the expenditures reported were in cash basis. In addition, the expenditures reported for salaries, were based on a manual calculation of hours worked times rate per hour, instead of actual salaries paid.		SF-425 reports are already being made in Cash-Basis	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-005 (See Finding Reference Number 2019-011)		As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not prepared.		SF-425 are being updated and will be sent quarterly to EPA	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-006 (See Finding Reference Number 2019-012)				The Grant Manager keeps a record of the differents grants in wich the amount of funds, employee-related expenses, time worked and other expenses are included. The Finance Office will make the adjustments and changes to the data of the differents grants in both PRIFAS and RHUM.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21






GOBIERNO DE PUERTO RICO

Departamento de Agricultura

2019-007 (See Finding Reference Number 2019-001)	Reporting	This is a Systemic problem; the Department didn't have an adequate internal control to verify the required information before the submission of the report. The personnel in charge doesn't have access to PRIFAS (accounting system) and also doesn't have the adequate training to comply with the reporting requirements.	We recommend management to implement internal controls over financial reporting in order to assure compliance with this reporting requirement.	It will be required a new section will be established within the finance department of the Agriculture department where specific personnel will be in charge to work with the federal agreements. These people will have access to PRIFAS and any accounting system necessary for federal accounts. If necessary, training will be requested to carry out these tasks. With this implementation, the requirements outlined in this report can be met. The Finance Department will correct what has already been done from the PRIFAS and RHUM modules. Subsequently, the manager of the Grant will send the data of the attendance or changes of the personnel to the payroll area so that from there the time report with its changes and awards corresponding to the payroll expenses can be made.	Mrs. Ivelisse Santaliz -Finance Director,Mr. Noel Toro- Human Resources Director, Mr. David Padilla-Plant Health Director, Shirley Cruz-person un charge of the federal agreement and Mr. Jesus Santiago-Auxiliary Secretary	YES	NO	FY2020-21
2019-008 (See Finding Reference Number 2019-002)		During our audit procedures of internal controls and compliance for allowable costs we found the following deficiencies: (a) we requested a list of employees with their time sheets that reflects the actual hours worked daily and their fringe benefits and we noted that the time reports do not specified the awards to be charged for the payroll expenditure. (b) in the accounting system PRIFAS the employees are identified by an award that is incorrect. (c) from the list of employees requested on (a), we noticed that two of the employees are in a pre-retirement plan since January 1, 2017, these costs were charged to PRIFAS to the Federal program when they should have been charged to the operational fund of the Department.		The Finance Department will correct what has already been done from the PRIFAS and RHUM modules. Subsequently, the Grant manager will send the data of the attendance or changes of the personnel to the payroll area so that from there the time report with its changes and awards corresponding to the payroll expenses can be made. Adjustments are already being made in PRIFAS and verification will continue to be followed for future changes.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-009 (See Finding Reference Number 2019-003)		As part of our audit procedures we requested the Grant Award to read the requirements of the program and we noted that the agreement have an approved budget that indicated the cost share of federal funds and state funds. Therefore, we requested to the information was received to evidence with the program compliance requirements.		All grants will be awarded their allocations and support with wich we determine and validate them.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-010 (See Finding Reference Number 2019-004)		As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not indicated that were prepared under accrual basis of accounting, although, the expenditures reported were in cash basis. In addition, the expenditures reported for salaries, were based on a manual calculation of hours worked times rate per hour, instead of actual salaries paid.		To carry out the SF-425 report, the GL-200 and RHUM system will be used, wich are detailde by employees and by individual biweekly transactions.	Mrs. Ivelisse Santaliz - Finance Director		NO	FY2020-21
2019-011 (See Finding Reference Number 2019-005)		As part of our audit procedures for reporting we verified the requirements of the report SF-425 and we noted that the reports were not prepared.		The GL-200 and RHUM system will be analyzed and detailed so that the allocations are more precise and reliable. We will work in coordination with Grant Manager and the Payroll Office giving wrtitting knowledge to Finance Department.	Mrs. Ivelisse Santaliz -Finance Director,Mr. Noel Toro- Human Resources Director, Mr. David Padilla-Plant Health Director, Shirley Cruz-person un charge of the federal agreement and Mr. Jesus Santiago-Auxiliary Secretary		NO	FY2020-21
2019-012 (See Finding Reference Number 2019-006)		During our audit procedures of the SEFA prepared by the Department we identified material misstatements related to the programs reported in the schedule. Two Federal programs were reported with the incorrect CFDA number in the SEFA; adjustments were proposed in order to reconcile the information with the financial statement.		A correct accounting record will be established. The information that is entered into the system related to federal spending will be verified in more detail. In this way the information provided in the SEFA will be more accurate.	Mrs. Ivelisse Santaliz -Finance Director,Mr. Noel Toro- Human Resources Director, Mr. David Padilla-Plant Health Director, Shirley Cruz-person un charge of the federal agreement and Mr. Jesus Santiago-Auxiliary Secretary		NO	FY2020-21

Approved by:   
 Date: 29-9-20