GOVERNMENT OF PUERTO RICO
OFFICE OF LEGISLATIVE SERVICES OF THE LEGISLATIVE ASSEMBLY

BASIC FINANCIAL STATEMENTS AND SUPPLEMENTARY INFORMATION

FOR THE FISCAL YEAR ENDED JUNE 30, 2020

(WITH THE ADDITIONAL REPORT REQUIRED BY THE GOVERNMENT AUDITING STANDARDS)

CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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Pages

Part I – Financial:

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PART I

FINANCIAL

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202 Gautier Benitez Ave.
Consolidated Mall C-31
PO Box 8369
Caguas, PR 00726-8369
Phones: (787) 746-0510 / 1185 / 1370
Fax: (787) 746-0525
cpadiazmartinez.com

INDEPENDENT AUDITOR'S REPORT

To the Director of the
Office of Legislative Services of the Legislative Assembly
of the Government of Puerto Rico
San Juan, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, and each mayor fund of the **Office of the Legislative Services of the Legislative Assembly of the Government of Puerto Rico (Office)**, as of and for the fiscal year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise the **Office**'s basic financial statements as listed in the Table of Contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

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

We were unable to obtain sufficient appropriate audit evidence about the deferred outflows/inflows of resources, liabilities, and expenses related to pension and other postemployment benefits of the governmental activities and disclosures in the accompanying notes. As discussed in Notes 10 and 11 to the financial statements, the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (PRERS) has not issued audited financial statements as of and for the Fiscal Year ended June 30, 2019 nor has provided to the **Office** the required information to record transactions related to pension and other postemployment benefits as of and for the Fiscal Year ended June 30, 2020. Amounts reported in the government-wide financial statements as deferred outflows of resources, deferred inflows of resources, net pension liability, and net other postemployment benefits liability were derived from the application of the proportional share included in the audited Schedules of Employer Allocations, and Schedules of Employer Allocations and Schedules of OPEB Amounts by Employer, published by the PRERS, cost-sharing multiple-employer pension plan for the Fiscal Year ended June 30, 2018. Accordingly, the **Office** did not record the current pension expense, changes in deferred outflows/inflows of resources, net pension liability, net other postemployment benefits liability, and additional disclosures, and supplementary information required by generally accepted accounting principles for pension and other postemployment benefits as of and for the Fiscal Year ended June 30, 2020. The amounts by which this situation would affect the presented liabilities, deferred outflows of resources, deferred inflows of resources, net position, and expenses has not been determined.

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

In our opinion, except for the possible effects of the matter described above in the "*Basis for Qualified Opinion on Governmental Activities and Note Disclosure Regarding Pensions Plan and Other Post-Employment Benefits Plan"* paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the **Office** as of June 30, 2020 and the respective changes in financial position thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of each major funds, and the aggregate remaining fund information of the **Office**, as of June 30, 2020, and the respected changes in the financial position and, where applicable, cash flows thereof for the fiscal year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

*The **Office of Legislative Services** – Only Basic Financial Statements*

As discussed in Note 1, the basic financial statements of the **Office** are intended to present the financial position and the changes in financial position of only that portion of the governmental activities of the financial reporting entity of the Government of Puerto Rico that is attributable to the transactions of the **Office**. They do not purport to, and do not, present fairly the financial position of the Government of Puerto Rico as of June 30, 2020, 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.

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

The **Office** is part of the Government of Puerto Rico (Government). The accompanying financial statements of the **Office** have been prepared assuming that the Government will continue as a going concern. As discussed in Note 14 on pages 59-61 to the basic financial statements, the Government's recurring deficits, negative financial position, further deterioration of its economic condition, and inability to access the credit markets raises substantial doubt about the Government's ability to continue as a going concern. Management's plans regarding these matters are also described in Note 14. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, on pages 6-19, budgetary comparison information, on pages 110-111, and employees' retirement systems information, on pages 112 through 114 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information related to management's discussion and analysis, and budgetary comparison information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance. We were unable to apply certain limited procedures to the required supplementary information related to employees' retirement systems information applicable to **Office**, in accordance with auditing standards generally accepted in the United States of America. We do not express an opinion or provide any assurance on the information.

Other Reporting Required by *Governmental Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 27, 2021 on our consideration of the **Office**'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 **Office**'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
May 27, 2021

Stamp No. E438164 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

The following is a discussion and analysis of the Office of Legislative Services of the Legislative Assembly (Office)'s financial performance, including an overview and analysis of the financial activities of the Office for the fiscal year ended June 30, 2020. Readers should consider this information in conjunction with the information included in our letter of transmittal, which can be found preceding this narrative, and with the Office's financial statements, including the notes to the financial statements, which are located after this analysis.

FINANCIAL HIGHLIGHTS

Government-wide Highlights

The government-wide financial statements report information about the Office as a whole using the economic resources measurement focus and accrual basis of accounting:

- The Office's net deficit amounted to $1,811,466 as of June 30, 2020. Such net position decreased by $5,445,150 during the fiscal year ended June 30, 2020. This decrease is mostly attributable to decrease in total revenues by $2,571,357 and consumption of cash available from previous year during the year.
- The total assets of the Office decreased by $5,284,631 during the fiscal year ended June 30, 2020. This decrease is mainly attributable to a decrease in the current assets by $5,141,006 at the end of the fiscal year.
- The total liabilities of the Office amounted to $9,554,968 comprised of the accrual required under GASB No. 34 for vacations and sick leave in the amounts of $1,380,534, $732,458 due to creditors and the accrual required under GASB No. 68 for the proportionate share of the "collective" net pension liability in the amount of $6.981,282 and GASB 75 other post-employment liability of $460,694 at the close of the fiscal year ended June 30, 2020.
- The Office of Legislative Services has the resources to meet its ongoing obligations, including the liabilities for accrued vacations and sick leave.

Fund Highlights

The fund financial statements provide detailed information about the Office's most significant funds using the current financial resources measurement focus and modified accrual basis of accounting:

- At the close of the current fiscal year, the Office's governmental funds reported combined ending fund balances of $9,779,047, a decrease of $5,109,324 or -34.32% when comparing with the prior year.
- The General Fund reported an excess of expenditures over revenues and other financing resources $5,501,324 and unassigned fund balance of $6.2 million.

General Financial Highlights

- The net investment in capital assets from governmental activities as of June 30, 2020 was $430,000 (net of accumulated depreciation of $1,687,120).
- The final budget of the Office for the fiscal year ended June 30, 2020 was $5,721,280. The Office achieved an economy of $396,090 in its management of the general fund budget for the fiscal year ended June 30, 2020.

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OVERVIEW OF THE FINANCIAL STATEMENTS

This management's discussion and analysis is required supplementary information to the basic financial statements and is intended to serve as introduction to the basic financial statements of the Office. The basic financial statements are comprised of the three components: (1) government wide financial statement, (2) fund financial statements, and (3) notes to the basic financial statements.

Basic Financial Statements

The Office's basic financial statements consist of two kinds of statements, each with a different view of the Office's finances. The Government-Wide Financial Statements provide both long-term and short-term information about the Office's overall financial status. The Fund Financial Statements focus on major aspects of the Office's operations, reporting that operations in more detail than the government-wide statements. The following figure summarizes the major features of the financial statements. The overview section below also describes the structure and contents of each of the statements in more detail.

	GOVERNMENT-WIDE STATEMENTS	FUND FINANCIAL STATEMENTS
		GOVERNMENTAL
SCOPE	Entire entity	The day-to-day operating activities of the Office for basic governmental services
ACCOUNTING BASIS AND MEASUREMENT FOCUS	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus
TYPE OF ASSET, LIABILITY, AND DEFERRED OUTFLOWS/INFLOWS OF RESOURCES INFORMATION	All assets and liabilities, both financial and capital, short-term and long-term All deferred outflows and deferred inflows of resources	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included All deferred outflows and deferred inflows of resources
TYPE OF INFLOW AND OUTFLOW INFORMATION	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the year; expenditures when goods or services have been received and payment is during the year or soon thereafter

- ***New Significant Accounting Standards Implemented***

  In fiscal year 2018-2019, the Office adopted GASB No. 95, *Postponement of the Effective Dates of Certain Authoritative Guidance*, that are effective immediately for all not adopted new statements of financial accounting standards issued by the Governmental Accounting Standards Board (GASB):

  - Statement No. 83, *Certain Asset Retirement Obligations*

continue

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

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

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

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

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

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

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

Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

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

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

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

Statement No. 92, *Omnibus 2020*. The objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing practice issues that have been identified during implementation and application of certain GASB Statements.

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

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

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

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

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

- ***Government-Wide Financial Statements***

The government-wide statements report information about the Office as a whole using accounting methods similar to those used by private-sector businesses. They are prepared using the flow of economic resources measurement focus and the accrual basis of accounting.

Statement of Net Position – Presents information on all the Office's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the difference between them reported as net position.

Net Position = (Assets + Deferred Outflows of Resources) –
(Liabilities + Deferred Inflows of Resources)

Over time, increases or decreases in net position may serve as a useful indicator of whether its financial position is improving or deteriorating. Other non-financial factors such as the condition of the Office's infrastructure may need to be considered to assess the overall financial position of the Office.

Statement of Activities – The *Statement of Activities* presents information showing how the Office's net position (deficit) changed during the year. All changes in net position (current year's revenues less expenses) are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected service charges and earned but unused vacation leave). The *Statement of Activities* is focused on both the gross and net cost of various governmental activities. This is intended to summarize and simplify the reader's analysis of the revenues and costs of various state activities and the degree to which activities are subsidized by general revenues.

The governmental activities of the Office include general government, and operational purposes. These activities are primarily financed through legislative appropriations (governmental activities).

The government-wide financial statements can be found on pages 20 and 21 of this report.

continue

- ***Fund Financial Statements***

A fund is a group of related accounts used to maintain control over resources that are segregated for specific activities or objectives. The Office, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The fund financial statements provide more detailed information about the Office's most significant funds. Funds are accounting devices that the Office uses to keep track of specific sources of funding and spending for particular purposes. Some funds are required by Federal and Government regulations, as well by bond covenants.

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

As required by GASB Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent.

In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year. At the end of the current fiscal year, the Office's governmental funds reported combined ending fund balances of $10 million. Of this amount, the General Fund of presents an Unassigned Fund Balance of $6.3 million, that is available balance for spending at the government's discretion. The remainder of fund balance is nonspendable, restricted, committed or assigned to indicate that is not available for new spending because it has already been committed.

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

The Office maintains several individual governmental funds. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for two major funds and an aggregate total for all non-major funds. The Office's major governmental funds are the General Fund and Special Fund.

The General Fund is the chief operating fund of the Office. At the end of the current fiscal year, the General Fund balance was $6.2 million.

The governmental fund financial statements can be found on pages 22 through 25 of this report.

- ***Notes to the Basic Financial Statements***

The notes provide additional information that is essential to a full understanding of the data provided in the governmental-wide and fund financial statements. The notes to the basic financial statements can be found on pages 26 through 108 of this report.

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- ***Required Supplementary Information***

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

  The *Schedule of Revenues and Expenditures – Budget and Actual* can be found on the pages 110-111 of this report.

- ***Required Supplementary Information – Employees' Retirement System***

  The required supplementary information reported are related to the implementation of GASB Statement No. 68 and GASB Statement No. 71 for pension liability reporting, are presented immediately following the notes to the financial statements and can be found on pages 112-114 of this report.

FINANCIAL ANALYSIS OF THE OFFICE AS A WHOLE

Government-Wide Financial Statements Analysis

The following Table presents a summary of the Statements of Net Position as of June 30, 2020 and 2019:

Table 1

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Statement of Net Position
As June 30,

	Governmental Activities		Total	
			Dollar Change	Percent Change
	2020	**2019**	**2020**	**2020**
Current Assets	$ 10,511,505	$ 15,652,511	$ (5,141,006)	-32.84%
Capital Assets	430,000	573,625	(143,625)	-25.04%
Total Assets	10,941,505	16,226,136	(5,284,631)	-32.57%
Deferred Outflows of Resources	917,358	917,358	-	0.00%
Current Liabilities	851,470	846,299	5,171	0.61%
Noncurrent Liabilities	8,703,498	8,548,150	155,348	1.82%
Total Liabilities	9,554,968	9,394,449	160,519	1.71%
Deferred Inflows of Resources	4,185,361	4,185,361	-	0.00%
Net Position:				
Net Investment in Capital Assets	430,000	573,625	(143,625)	-25.04%
Restricted	3,600,452	4,010,015	(409,563)	-10.21%
Unrestricted	(5,911,918)	(1,019,956)	(4,891,962)	479.62%
Total Net Position	$ (1,881,466)	$ 3,563,684	$ (5,445,150)	-152.80%

continue

Analysis of Net Position

As noted earlier, net (deficit) position may serve over time as a useful indicator of a government's financial position. The Office's liabilities and deferred inflows exceeded its assets and deferred outflows by $1.9 million at the close of the most recent fiscal year.

A portion of the Office's net (deficit) position reflects its investment in capital assets (e.g., equipment, computer equipment, improvement to facilities, furniture, vehicles, and intangibles) for $430 thousands [total capital assets less accumulated depreciation]. The Office uses these assets to provide services to legislative assembly and consequently, these assets are not available for future spending.

Restricted net position represents resources that are subject to external restrictions on how they may be used.

Unrestricted net position (deficit) is the part of the net position that can be used to finance day-to-day operations without constrains established by debt covenants, enabling legislation or other legal requirements.

As of June 30, 2020, the Office presented unrestricted net position (deficit) of ($5.9) million. This balance was affected by long term obligations such as compensated absences $1.3 million, $460,694 for Net Other Post-Employment Benefits and Net Pension Liabilities of $7 million, respectively, for which the Office did not provide funding in previous budgets. Historically, such obligations have been budgeted on a pay as you go basis without providing funding for their future liquidation. There is $5,445,150 in loss net position reported in connection with the Office's governmental activities.

Changes in Net Position

The following table summarizes the changes in net position for the years ended June 30, 2020 and 2019:

Table 2

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Changes in Net Position
As June 30,

	Governmental Activities		Total	
			Dollar Change	Percent Change
	2020	**2019**	**2020**	**2020**
Revenues:				
General Revenues:				
Intergovernmental	$ 5,721,280	$ 8,292,637	$ (2,571,357)	-31.01%
Total Revenues	5,721,280	8,292,637	(2,571,357)	-31.01%
Governmental Activities Expenses:				
General Government- Administrative and Operating	10,882,030	10,516,097	365,933	3.48%
Internships	284,400	355,614	(71,214)	-20.03%
Total Expenses	11,166,430	10,871,712	294,718	2.71%
Changes in Net Position	**(5,445,150)**	**(2,579,075)**	**(2,866,075)**	111.13%
Net Positon - Beginning, as Restated	3,563,684	6,142,759	(2,579,075)	-41.99%
Net (Deficit) Position - Ending	**$ (1,881,466)**	**$ 3,563,684**	**$ (5,445,150)**	-152.80%

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Analysis of Changes in Net Position

The Office's net (deficit) position overall decreased by $5,445,150 during fiscal year 2019-2020, compared to a $2,579,075 decrease last fiscal year. A discussion of these changes is presented in the government activities below.

Governmental Activities. The Office's net position decreased by $5,445,150 the current fiscal year. For the most part, decreases in expenses were related to payroll and related expenses for the year.

Approximately 100% of the Office's revenues came from state contributions. The Office's expenses cover a range of services. The largest expenses are general administration with 95.0% of total expenses. Expenses are maintained similar as 2019.

The Office's major expense is related to salaries, benefits and payroll taxes, which represents 61.1% and 60.3% of total expenses for the fiscal years ended June 30, 2020 and 2019, respectively.

The following Table 3 focuses on the cost of each of the Office's largest functions/programs as well as each functions/program's net cost (total cost less fees generated by the programs and program–specific intergovernmental aid):

Table 3

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Agency Cost of Programs/Functions
Fiscal Years Ended June 30

	Total Cost of Services		Net Cost of Services	
	2020	**2019**	**2020**	**2019**
Governmental Activities:				
General Government - Administrative and Operating	$ 10,882,030	$ 10,516,097	$ 10,882,030	$ 10,516,097
Contributions and Special Programs	284,400	355,614	284,400	355,614
Total Expenses	$ 11,166,430	$ 10,871,712	$ 11,166,430	$ 10,871,712

FINANCIAL ANALYSIS OF THE OFFICE'S FUNDS

Governmental Funds

The focus of the Office's governmental funds is to provide information on near-term inflows, outflows and balances of resources available for spending. Such information is useful in assessing the Office's financing requirements. Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the government honors constraints on the specific purposes for which amounts in those funds can be spent (see Table 4).

continue

Table 4

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Fund Balances
As of June 30,

	FUND BALANCES							
	Nonspendable		Restricted		Unassigned		**Total**	
	2020	2019	2020	2019	2020	2019	2020	2019
Funds:								
General	$ 30,545	$ 34,940	$ -	$ -	$ 6,148,051	$ 10,843,417	$ 6,178,596	$ 10,878,357
Special Funds	11,232	7,021	3,589,219	4,002,993	-	-	3,600,451	4,010,015
Total	$ 41,777	$ 41,961	$ 3,589,219	$ 4,002,993	$ 6,148,051	$ 10,843,417	$ 9,779,047	$ 14,888,371

As of the end of the fiscal year 2020, the Office's governmental funds reported a combined ending balance of $9,779,047. The general fund is the chief operating fund of the Office. The combined fund balances include non-spendable fund balance amounting to $41,777 as of June 30, 2020. This is the portion of fund balances that cannot be spent readily with cash or is legally or contractually required not to be spent in the General Fund or there are no expectations to be converted in cash soon enough to affect the current period. There are restricted fund balances amounting to $3,589,219. This is the portion of fund balance that reflects resources that are subject to externally enforceable legal restrictions to pay for specific program purposes. Accordingly, since there is an excess of non-spendable, restricted fund balances over total fund balances, an unassigned fund balance of $6,148,051 was reported in the governmental funds on June 30, 2020.

The Office's fund balance decreased by $5,109,324 or 34.32%, as a result of the current fiscal year's change in financial position. See additional related comment in the following section titled general fund budgetary highlights.

Table 5

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
General Fund
As of June 30,

	2020	**2019**	Dollar Change	Percent Change
Revenues:				
Appropriation from Commonwealth	$ 5,721,280	$ 8,292,637	$ (2,571,357)	-31.01%
Other	-	-	-	
Total Revenues	5,721,280	8,292,637	(2,571,357)	-31.01%
Expenditures				
General Government	10,544,253	10,439,538	104,715	1.00%
Contributions and Special Programs	284,400	355,614	(71,214)	-20.03%
Capital Outlay	1,951	80,753	(78,802)	-97.58%
Total Expenditures	10,830,604	10,875,905	(45,301)	-0.42%
Net Change in Fund Balance	**$ (5,109,324)**	**$ (2,583,268)**	**$ (2,526,056)**	97.79%

continue

GENERAL FUND BUDGETARY HIGHLIGHTS

The General Fund's Budget for the fiscal year ended June 30, 2020 was $5,721,280, and the actual expenditures charge to the current budget were $5,325,190. The total expenditures represented 93.1% of the total budget available for the fiscal year. The Office's expenditure rate of 93.1% represents an increase rate when compared to the prior year's performance of 75.89%.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of the fiscal year, the Office has invested $430,000 (net of accumulated depreciation) in a broad range of capital assets, including vehicles and equipment. This amount represents a net decrease of $143,624 or (25.04%) less than prior year. The Office acquired a total of $1,950 of capital assets during the fiscal year 2019-2020.

Table 6 present the components of capital assets during the fiscal years 2020 and 2019:

Table 6

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Capital Assets, Net
As of June 30,

Description	2020	2019	Dollar Change	Percent Change
Governmental Activities:				
Depreciable Capital Assets (Net):				
Equipment	$ 101,348	$ 130,238	$ (28,890)	-22.18%
Computer Equipment	135,966	178,261	(42,295)	-23.73%
Library	253	1,486	(1,233)	-82.97%
Improvement to Facilities	4,143	12,703	(8,560)	-67.39%
Furnitures	174,001	227,118	(53,117)	-23.39%
Vehicles	14,289	23,819	(9,530)	-40.01%
Total Capital Assets:	$ 430,000	$ 573,625	$ (143,625)	-25.04%

Additional information on the Office's capital assets can be found in Note 6 to the basic financial statements on page 42 of this report.

LONG-TERM LIABILITIES

At year-end, the Office had $8.8 million in outstanding debts including compensated absences, Net Pension Liability for the implementation of GASB No. 68, and Other Post-Employment Benefits for the implementation of GASB No. 75. This amount represents an increase of $192,202, or (2.23%) with respect to prior year.

continue

Table 7 present the components of outstanding long-term debts as of June 30, 2020 and 2019:

Table 7

Commonwealth of Puerto Rico
Office of Legislative Services of the Legislative Assembly
Outstanding Long-Term Debt
As of June 30,

	2020	2019	Dollar Change	Percent Change
Governmental Activities:				
Net Pension Liability	$ 6,981,282	$ 6,981,282	$ -	0%
Other Post-Employment Benefits Obligations	460,694	460,694	-	0%
Compensated Absences	1,380,534	1,188,332	192,202	16.17%
Total	$ 8,822,510	$ 8,630,308	$ 192,202	2.23%

More detailed information about the Office's long-term liabilities is presented in Note 8 to the basic financial statements on page 43 of this report.

DEFERRED OUTFLOWS / INFLOWS OF RESOURCES

Deferred Outflows of Resources

Deferred outflows of resources are new to the Office's Statement of Net Position for this fiscal year. This classification balance, although similar to "assets," is set apart because these items do not meet the technical definition of being the Office asset on the date of these financial statements. In other words, these amounts are not available to pay liabilities in the way assets are available. When all the recognition criteria are met, the deferred outflow of resources will become an expense/expenditure.

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

Deferred Inflows of Resources

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

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

continue

More detailed information about the Office's deferred outflows of resources and deferred inflows of resources is presented in Note 7 to the financial statements on pages 42-43 of this report.

GOING CONCERN – GOVERNMENT OF PUERTO RICO

As explained on Note 14 to the financial statements on pages 59-61 of this report, the Government of Puerto Rico (Government) currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Government's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Government's tax base, has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services, like the Office, which is part of the Government.

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

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

Also, attention was directed to Note 15 to the basic financial statements on pages 61-92 of this report, related to 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. As part of the requirement imposed by this bill, the Commonwealth must reduce the deficit by increase revenues and reduce substantially expenses, including subsidies to the municipalities of Puerto Rico. The most recent Fiscal Plan was approved in June 2020.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

According to the Puerto Rico Planning Board most recent report submitted to the Puerto Rico's Governor on March 29, 2019, Puerto Rico's real gross national product decreased by 4.7% on fiscal year 2018 and by 3.0% on fiscal year 2017. The Puerto Rico Planning Board projected a decrease on the gross national product between of 16.1% for the fiscal year 2018 and increase of 5.3% for 2019 based on pre-measures and structural reforms. The Planning Board's forecast considered the estimated effect of the projected growth of the United States gross domestic product, tourism activity, personal consumption expenditures, and federal transfers to individuals.

Employment

According to the Economic Report to the Governor issued by the Puerto Rico Planning Board (PRPB) in April 2020, the total of people employed during the fiscal year 2019 amounted to approximately 986,000 or an increase of 1.5% when compared to fiscal year 2018. During the first semester of the fiscal year 2019, total of people employed amounted to 986,000 or an increase of approximately 1.5%, when compared to the previous year. The reduction in total employment began in fiscal year 2007. When employments total was 1,263,000 and has continued consistently through fiscal year 2019.

continue

The preliminary average unemployment rate for the fiscal year 2018 and determined by the PRPB was 10.3% This represented a reduction of 1.2% when compared to fiscal year 2017 (11.5%). The preliminary average participation rate for the fiscal year 2018 was 40.5%. This represented an increase of 0.4% when compared to the fiscal year 2017 (40.1%). 2017 information was not available. The Office applied a conservative approach in development budget estimates based on Government of Puerto Rico crisis.

The Office expects limited changes in revenues for the next year due to Puerto Rico economic rescission. Budgeted expenditures are expected to decrease accordingly to the projected revenues. Among planned projects, this budget may be adjusted in accordance with PROMESA Act. The Office adopted the 2020-2021 fiscal year budgets on July 1, 2020. The legislative appropriations for the fiscal year ending June 30, 2021 amount to $8,292,637 this represents a reduction of $2,182,123 when comparing to 2020.

CONTACTING THE OFFICE'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Office's finances for those interested. Also, this report serves to demonstrate the Office's accountability for the money it receives from legislative appropriations. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of Legislative Services, Office of Finance, PO Box 9023986, San Juan, PR 00902-3986.

STATEMENT OF NET POSITION
JUNE 30, 2020

	GOVERNMENTAL ACTIVITIES
ASSETS:	
Current Assets:	
Cash	$ 10,356,291
Receivables (Net):	
Governmental Entities	77,377
Other	36,060
Office Supplies	41,777
Total Current Assets	**10,511,505**
Non-Current Assets:	
Capital Assets, Net	430,000
TOTAL ASSETS	**10,941,505**
DEFERRED OUTFLOWS OF RESOURCES:	
Contributions to Employees Retirement System	917,358
TOTAL DEFERRED OUTFLOWS OF RESOURCES	**917,358**
LIABILITIES:	
Current Liabilities:	
Accounts Payable	633,107
Due to Governmental Units	94,921
Accrued Liabilities	4,430
Short-Term Obligations:	
Compensated Absences	119,012
Total Current Liabilities	**851,470**
Non-Current Liabilities:	
Compensated Absences	1,261,522
Net Other Post-Employment Benefits Liability	460,694
Net Pension Liability	6,981,282
Total Non-Current Liabilities	**8,703,498**
TOTAL LIABILITIES	**9,554,968**
DEFERRED INFLOWS OF RESOURCES:	
Unamortized Investment in Employees Retirement System	4,185,361
TOTAL DEFERRED INFLOWS OF RESOURCES	**4,185,361**
NET POSITION (DEFICIT):	
Net Investment in Capital Assets	430,000
Restricted for:	
Subsidies and Incentives	3,600,452
Unrestricted (Deficit)	(5,911,918)
TOTAL NET POSITION	**$ (1,881,466)**

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

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

Functions/Programs	Expenses	Program Revenues: Charges For Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Position
PRIMARY GOVERNMENT:					
Governmental Activities:					
General Government - Administrative and Operating	$ 10,882,030	$ -	$ -	$ -	$ (10,882,030)
Internships	284,400	-	-	-	(284,400)
Contributions and Special Programs	-	-	-	-	-
Total Primary Government	**$ 11,166,430**	**$ -**	**$ -**	**$ -**	**$ (11,166,430)**
	General Revenues:				
	Intergovermental				5,721,280
	Total General Revenues				5,721,280
	Total Transfers				-
	CHANGES IN NET POSITION				**(5,445,150)**
	Net Position, As Restated – Beginning of Year				3,563,684
	NET POSITION – ENDING OF YEAR				**$ (1,881,466)**

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

		GENERAL FUND		SPECIAL FUND		TOTAL FUNDS
ASSETS:						
Cash	$	6,604,818	$	3,751,473	$	10,356,291
Receivables (Net):						
Governmental Entities		77,377		-		77,377
Other		19,626		16,434		36,060
Inventory Supplies		30,545		11,232		41,777
Total Assets	**$**	**6,732,366**	**$**	**3,779,139**	**$**	**10,511,505**
LIABILITIES:						
Accounts Payable	$	458,849	$	174,258	$	633,107
Due to Governmental Units		94,921		-		94,921
Accrued Liabilities		-		4,430		4,430
Total Liabilities		**553,770**		**178,688**		**732,458**
FUND BALANCES:						
Nonspendable - Inventory		30,545		11,232		41,777
Spendable:						
Restricted		-		3,589,219		3,589,219
Committed		-		-		-
Assigned		-		-		-
Unassigned		6,148,051		-		6,148,051
Total Fund Balances		6,178,596		3,600,451		9,779,047
Total Liabilities and Fund Balances	**$**	**6,732,366**	**$**	**3,779,139**	**$**	**10,511,505**

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

Total Fund Balances – Government Funds (Page 22)		**$ 9,779,047**
Amount reported for Governmental Activities in the Statement of Net Position (Page 20) are different because:		
Capital Assets used in governmental activities are not financial resources and therefore are not reported in the funds. In the current period, these amounts are:		
Capital Assets	$ 2,117,120	
Accumulated Depreciation	(1,687,120)	
Total Capital Assets		430,000
Deferred Outflows of Resources in Governmental Activities are paid in the current available soon period and therefore are reported in the funds.		917,358
Deferred Inflows of Resources in Governmental Activities corresponded to future period and therefore are not reported in the funds.		(4,185,361)
Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:		
Net Pension Liability	(6,981,282)	
Net Other Post-Employment Benefits Liability	(460,694)	
Accrued Compensated Absences	(1,380,534)	
Total Long-Term Liabilities		(8,822,510)
Total Net Position of Governmental Activities (Page 20)		**$ (1,881,466)**

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

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

	GENERAL FUND	SPECIAL FUND	TOTAL FUNDS
REVENUES:			
Intergovernmental	$ 4,971,280	$ 750,000	$ 5,721,280
Total Revenues	**4,971,280**	**750,000**	**5,721,280**
EXPENDITURES:			
Current:			
General Government - Administrative and Operating Activities	9,671,041	873,212	10,544,253
Internships	-	284,400	284,400
Capital Outlays	-	1,951	1,951
Total Expenditures	**9,671,041**	**1,159,563**	**10,830,604**
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	**(4,699,761)**	**(409,563)**	**(5,109,324)**
Net Change in Fund Balances	**(4,699,761)**	**(409,563)**	**(5,109,324)**
Fund Balances – Beginning	10,878,357	4,010,014	14,888,371
FUND BALANCES – ENDING	**$ 6,178,596**	**$ 3,600,451**	**$ 9,779,047**

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

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES

FOR THE FISCAL YEAR ENDED JUNE 30, 2020

Net Change in Fund Balances – Government Funds (Page 24)		**$ (5,109,324)**
Amount reported for Governmental Activities in the Statement of Activities (Page 21) are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Depreciation Expense	$ (145,575)	
Capital Outlays	1,951	
Excess of Depreciation Expense over Capital Outlays		(143,624)
Some expenses reported in the Statement of Activities do not require the use of current financial resouces and therefore are not reported as expenditures in governmental funds. These activities consist of:		
Change in Compensated Absences	(192,202)	
Change in Net Other Post-Employment Benefits Liability	-	
Change in Net Pension Liability	-	
Total Additional Expenses		(192,202)
Change in Net Position of Governmental Activities (Page 21)		**$ (5,445,150)**

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

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Office of Legislative Services (the “Office”) is an integral part of the Government of Puerto Rico created under the Resolution No. 11 of January 27, 1954 by the Legislature of Puerto Rico. The Office serves all members of the legislative assembly of Puerto Rico of all political parties, which request and use their professional services, as well as commissions and legislative bodies.

The Government of Puerto Rico was constituted on July 25, 1952, under the provisions of its Constitution as approved by the people of Puerto Rico and the Congress of the United States of America. The Government’s Constitution provides for the assignation of powers to the executive, legislative and judicial branches of the government. The Government assumes responsibility for public safety, public health, public housing, wealth, education and economic development.

The Office performs a variety of functions, of great importance to the mission undertaken by the Legislative Assembly of Puerto Rico. Among the main functions carried out by this Office are the following: considering and resolving legal questions submitted to it, preparing draft bills and resolutions, as well as, reviewing legislative measures prepared by the legislators, drafting opinions, of legal and constitutional nature for the Legislature and its members concerned with the proposed legislation, conducting research and preparing reports related to legislation and other legislative matters, providing advice to the different various legislative committees and the legislators who seek its services for drafts bills of special or general legislation, expediting the process for searching, obtaining and maintaining current information as to the questions and issues facing the Legislature related to the organization and operation of the Government; translates draft bills and resolutions, studies and reports of legislative interest and laws approved by the Governor into English and Spanish.

Financial Reporting Entity

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

Effective July 1, 2010, the Office became fiscally autonomous pursuant to the provisions of Act No. 230 of July 23, 1974, as amended on September 11, 2004, known as the "Government of Puerto Rico Accounting Law". The funds of the Office are under the custody of the Secretary of Treasury of Puerto Rico until transferred to the Office. The accompanying financial statements are issued solely and for the information and use of the Secretary of Treasury, the Director of the Office, the Governor, and the citizens of the Government of Puerto Rico.

Summary of Significant Accounting Policies

The accompanying basic financial statements of the Office have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as prescribed by the Governmental Accounting Standard Board (GASB). The GASB is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Basis of Presentation and Fund Accounting

The accompanying basic financial statements includes the organization units governed by the Office's management. In evaluating the Office as a reporting entity, management has addressed the entire potential component unit. The basic criteria for including a potential component unit within the reporting entity is if potential component unit are financially accountable and other organization for which the nature and significance of their relationship with the entity that exclusion would cause the Office's financial statements to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the Office's ability to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on the Office.

The relative importance of each criteria must be evaluated in light of specific circumstances in order to determine which components unit are to be included as part of the reporting entity. Our specific evaluation of the criteria applicable to the Office indicates that no organization meet the criteria to be included as component units. Accordingly, these basic financial statements present only the Office as the reporting entity.

The accompanying basic financial statements present the financial position of the governmental activities, business-type activities, each major governmental fund, and the aggregate remaining fund information of the Office at June 30, 2020, and the respective changes in financial position, and the cash flows, where applicable, thereof for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

In addition, the accompanying basic financial statements present the changes in the financial position (results of operations) of the governmental activities, each major governmental fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2020 in conformity with GAAP.

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

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

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

Required Supplementary Information – Management's Discussion and Analysis

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

Government-wide Financial Statements (GWFS)

While separate government-wide and fund financial statements are presented, they are interrelated. The GWFS (the *Statement of Net Position* and the *Statement of Activities*) report information of all the activities of the Office. For the most part, the effect of interfund activity has been removed from these financial statements.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

Governmental Funds Financial Statements (GFFS)

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

Each fund is a separate accounting entity with a self-balancing set of accounts used to record the financial transactions and balances of that entity. Individual funds have been established as stipulated by legal provisions or by administrative discretion. The Office uses fund accounting, which is designed to demonstrate legal compliance and to segregate transactions related to certain government functions or activities.

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

The following are the governmental funds presented in the financial statements as of, and for the year ended June 30, 2020:

<u>General Fund</u> – This fund includes the current financial resources, which relate to the general operations of the Office. These operations consist of the general administration and other activities not accounted for in the Incentive Fund and other non-major funds.

<u>Special Fund</u> – This major fund accounts for the financial resources related to the Special Assignment by the Government administered by the Office.

The financial statements of the governmental funds are the following:

Balance Sheet – Reports information on June 30, 2020 about the current financial resources (assets, liabilities, deferred inflows of resources and fund balances) of each major governmental fund.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Statement of Revenues, Expenditures and Changes in Fund Balances – Reports information about the inflows, outflows and balances of current financial resources of each major governmental fund for the fiscal year ended June 30, 2020.

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

During the course of operations, the Office has activity between funds for various purposes. Any residual balances outstanding at year end are reported as due from/to other funds. While these balances are reported in fund financial statements, certain eliminations are made in the preparation of the GWFS.

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

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

Notes to the Basic Financial Statements

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

Required Supplementary Information (Unaudited)

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

Required Supplementary Information – Employees Retirement System (Unaudited)

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, that is effective for the Office's fiscal year beginning July 1, 2014, revises existing standards for measuring and reporting pension liabilities for pension plans provided by the Office to its employees, and required supplementary information that include the Schedule of Proportionate Share of the Net Pension Liability and Schedule of Contributions to the Employees' Retirement Systems.

Required Supplementary Information – Other Postemployment Benefits (OPEB)

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 3.10% based on the asset allocation on the Commonwealth's general assets that are used to pay this benefit.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

In accordance with GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, that replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, changes similar to those implemented on GASB No. 67, *Financial Reporting for Pension Plans*, and No. 68, *Accounting and Financial Reporting for Pensions* should be made. As of June 30, 2020, the PRGERS has not issued, or made available information in order to properly adjust or disclose any deferred outflow/inflow of resources, change in Net OPEB Liability after implementation, applicable to the Office.

Measurement Focus and Basis of Accounting

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

Government-wide Financial Statements

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenue (including interest on deposits and investments) is generally recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Nonexchange transactions, in which the Office gives (or receives) value without directly receiving (or giving) equal value in exchange. On an accrual basis, revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been met, other than time requirements. Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

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

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

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

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

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

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

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Governmental Funds Financial Statements

The GFFS are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Under this method, revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For these purposes, the Office considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Revenues that the Office earns by incurring obligations are recognized in the same period as when the obligations are recognized. On June 30, 2020, all revenues sources met this availability criterion.

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

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

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

Stewardship, Compliance, and Accountability

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

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

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

Budgetary Control

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

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

Cash and Cash Equivalents

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

Inter-Fund Balances

Activities between funds that are representative of lending, borrowing arrangements outstanding at the end of the fiscal year are referred to as due to/from other funds/ (i.e. the current portion of inter-fund loans). Eliminations are made in the government-wide financial statements of the amounts reported as inter-fund receivables and payables.

Inventories

All inventories are valued at cost using the first-on/first-out (FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than when purchased. Inventories consist primarily of supplies held for consumption for the Office and are recorded in both government-wide and fund financial statements.

Receivables and Payables

Activity between funds that are representative of lending/borrowing arrangements outstanding at the end of the fiscal year are referred to as either “due to/from other funds” (i.e., the current portion of interfund loans) or “advances to/from other funds” (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as “due to/from other funds.” Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statement as “interfund balances”.

Advance between funds, as reported in the fund financial statements, if any, are offset by a fund balance reserve account in applicable governmental funds to indicate that they are not available for appropriation and are not expendable available financial resources.

Receivables consist of all revenues earned but not collected on June 30, 2020. These account receivables are shown net of estimated allowances for uncollectible accounts, which are determined upon past collection experience, historical trends, and current economic conditions. Receivables represent mostly service charges corresponding to June revenues collected during July and August 2020. Intergovernmental receivables in the other governmental funds represent amounts owed to the Office for reimbursement of expenditures incurred pursuant to state appropriations.

Accounts payable represent amounts, including salaries and wages, owed for goods and services received prior to year-end.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Risk Financing

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

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

The Office is authorized to deposit only in financial institutions approved by the Department of the Treasury of the Government of Puerto Rico, and such deposits should be kept in separate accounts in the name of the Office.

Capital Assets

Capital assets, which include equipment, computer and software, library, furniture, and vehicles, are reported in the applicable governmental activities' columns in the GWFS. Capital assets are defined by the Office as assets with an initial, individual cost of more than $500 (amount not rounded) and an estimated useful life in excess of three years.

As the Office constructs or acquires additional capital assets each period, they are capitalized and reported at historical cost. The reported value excludes normal maintenance and repairs which are essentially amounts spent in relation to capital assets that do not increase the capacity or efficiency of the item or extend its useful life beyond the original estimate. In the case of donations, the Office values these capital assets at the acquisition value of the item at the date of its donation.

Capital outlay is recorded as expenditures of the General Fund and other governmental funds and as assets in the GWFS to the extent the Office capitalization threshold is met. Depreciation and amortization expense are recorded only in the GWFS. The capital assets are depreciated using the straight-line method over the following estimated useful lives:

CAPITAL ASSETS	YEARS
Equipment	5
Computer Equipment and Software	5
Library	3
Furniture	5
Vehicles	5

Depreciation and amortization expense of capital assets is recorded as a direct expense of the function/program specifically identified with the asset. Depreciation and amortization of infrastructure is not allocated to various function/programs but reported as direct expense of the public works and urban development functions.

Impaired capital assets that will no longer be used by the Office, if any, are reported at the lower of carrying value or fair value. Impairment losses on capital assets with physical damages that will continue to be used by the Office are measured using the restoration cost approach. Impairments of capital assets that are subject to a change in the manner or duration of use, or assets affected by enactment or approval of laws or regulations or other changes in environmental factors or assets that are subject to technological changes or obsolescence, if any, are measured using the service units' approach.

Deferred Outflows/Inflows of Resources

Deferred outflows of resources and deferred inflows of resources are defined in GASB Concept Statement No. 4, *Elements of Financial Statements*, as the acquisitions and consumptions of net assets by the government that is applicable to future periods. Pursuant to GASB Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position",* and GASB Statement No. 65, *"Items Previously Reported as Assets and Liabilities",* the Office recognizes deferred outflows and inflows of resources.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

In addition to assets, the *Statement of Net Position* will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expenses/expenditures) until then.

In addition to liabilities, the *Statement of Net Position* will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

Based on this concept, the Office reports the deferred outflows of resources or deferred inflows of resources resulting from the implementation of GASB No. 68. Note 7 presents additional information about the composition of these items.

The Office has items, which arise under accrual basis and modified accrual basis of accounting that qualify for reporting in deferred outflows/inflows of resources. Accordingly, the items, related to pension system are reported in the government-wide *Statement of Net Position*, and *unavailable revenue,* is reported only in the governmental funds *Balance Sheet*. The governmental funds don't report *unavailable revenues*. This amount is deferred and recognized as an inflow of resources in the period that the amount becomes available.

Long-Term Obligations

The liabilities reported in the GWFS include other noncurrent liabilities (e.g., vacation, sick leave, claims and judgments, noncurrent liabilities to other governmental entities and third parties).

In the GFFS, expenditures for principal and interest payments, if any, for governmental fund general and special fund are recognized in the corresponding fund when due.

Compensated Absences

Compensated absences are accounted for under the provisions of GASB Accounting Standards Codification Section C60, *Compensated Absences*. Compensated absences include paid time off made available to employees in connection with vacation, sick leave and compensatory time. The liability for compensated absences recorded in the accompanying Statement of Net Position is limited to leave that: (1) is attributable to services already rendered on or before June 30, 2020 and (2) is not contingent on a specific event (such as illness) that is outside the control of the Office and the employee. The liability for compensated absences includes salary-related costs, which are directly and incrementally related to the amount of salary paid to the employee (such as employer's share of social security taxes and Medicare taxes).

The employees of the Office do not apply by the Act. No. 26 of April 29, 2017 (Act No. 26-2017), the employees of the Office are granted thirty (30) days of vacation and eighteen (18) days of sick leave annually. The employee has the right to accumulate the excess of vacation up to sixty (60) days and sick leave up to ninety (90) days, until December 31st of each year.

Compensated absences are accrued when incurred using the pay or salary rates in effect at the date of the *Statement of Net Position*.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Upon termination of employment, an employee receives compensation for all accumulated unpaid regular vacation leave at the current rate up to the maximum of sixty (60) days. When the reason for the separation is to qualify for the retirement for years of services or disability, a deferred pension or after having worked for at least ten (10) years of services without being a participant in a retirement system sponsored by the government you will also be entitled to pay of the lump sum of sick leave accumulated and not use up to maximum of ninety (90) days. However, if the employee worked ten years in the services within which some years, he has port of some retirement system sponsored by the government and the other were not involved, he will not be entitled to the payment of the mentioned license, except if he withdraws the contributions made to the retirement systems, which would make him a non-participant with 10 years or service.

Use of Estimates

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

Claims and Judgments

The estimated amount of the liability for claims and judgments, if any, which is due on demand, such as from adjudicated or settled claims, is recorded in the General Fund when the liability is incurred. The Long-Term Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, if any, which will require future available financial resources for its payment.

Fair Value

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

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

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

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

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

Level 2 - Inputs to the valuation methodology include:

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

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

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

Based on the criteria set forth above, the Office has classified its financial instruments as Level 2 instruments as of June 30, 2020.

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

The observability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer would be reported at the beginning of the fiscal year. For the fiscal year ended June 30, 2020, there were no transfers from Level 2 to other categories.

The following methods and assumptions were used to estimate the fair values of the most significant financial instruments on June 30, 2020. There have been no changes in valuation methods.

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

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

Fair value reporting requires management to make estimates and assumptions about the effects of matters that are inherently uncertain. The judgments made in determining the estimated fair value assigned to each financial instrument is significant and can materially impact the changes in net position and fund balances of the Office. The valuations are based on information available on June 30, 2020 and are based on expectations and assumptions that have been deemed reasonable by management.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

However, the difference between the estimated fair values and carrying values of the Office's financial instruments were not considered significant by the Office on June 30, 2020.

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 Government of Puerto Rico (ERS) as of June 30, 2014.

In addition, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, effective for the Office's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the Office to its employees. This Statement requires recognition of a liability equal to the Net Pension Liability, which is measured as the Total Pension Liability, less the amount of the pension plan's Fiduciary Net Position. The Total Pension Liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year-end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available.

This Statement requires that most changes in the Net Pension Liability be included in pension expense in the period of the change. To the extent practical, the financial statements presented for the periods affected should be restated. Also, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment to GASB 68, is required to be implemented simultaneously with the provisions of GASB 68.

The Office implemented both GASB Statements No. 68 and 71 for the fiscal year ending June 30, 2017 and the financial statements of the Office for the year ended June 30, 2016 were restated, with audited information available at the date of the Office's reports. During the past years, the ERS was reconstructed the employees' information and finally on November 2, 2018 issued the required Schedules of Employer Allocations and Pension Amounts by Employers as of June 30, 2016, necessary for final implementation of GASB No. 68 and the recognition of the values of the Net Pension Liability, Deferred Outflows / Inflows of Resources and Pension Expense items corresponding to the fiscal year 2017.

After that, and based in the fiscal crisis of the Commonwealth, was enacted the Act No. 106 of 2017 to establish a New Define Contribution Plan and create the "pay-as-you-go" scheme for payment of pensioners of the ERS and other two retirement systems and liquidating all assets of the Fiduciary Fund of the ERS. Accordingly, after that, the GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements No. 67 and 68* enter in substitution of GASB No. 68.

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

At the date of issuance of the basic financial statements of the Office, the ERS has not issued the corresponding audited financial statements as of June 30, 2020, nor the attachments required by GASB 68.

This statement establishes accounting and financial reporting for pensions provided to the employees of state and local government employers through pension plans that are administered through trusts that have the following characteristics:

- contributions from employers and nonemployer contributing entities to the pension plan and earnings on those contributions are irrevocable;
- pension plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms;
- pension plan assets are legally protected from the creditors of employers, nonemployer contributing entities, and the pension plan administrator. If the plan is a defined benefit pension plan, plan assets also are legally protected from creditors of the plan members.

For the purpose of applying the requirements of GASB No. 68, as amended, the state government of the Commonwealth is considered to be the sponsor of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS), a cost-sharing multi-employer Defined Benefit Pension Plan, and Defined Contribution Hybrid Program, in which the employees of the Office participate. The Office is considered a participant of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Commonwealth and the basic financial statements of such retirement systems are part of the financial reporting entity of the Commonwealth. Act No. 3 was enacted on April 4, 2013 (Act No. 3-2013), amended the Act No. 447-1951 for the purpose of establishing a major reform of the ERS effective on July 1, 2013. After that, and based in the fiscal crisis of the Commonwealth, was enacted the Act No. 106-2017 to establish a New Define Contribution Plan and create the "Pay-As-You-Go" scheme for payment of pensioners of the ERS and other two retirement systems (see Note 10).

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

Other Postemployment Benefits

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

In addition to the pension benefits described in Note 10, the Commonwealth provides other retirement benefits, such as Christmas Bonus, and postemployment healthcare benefits (OPEB) for its retired employees in accordance with local law. Substantially, all of the employees may become eligible for these benefits if they reach normal retirement age while working for the Commonwealth. There are no member or employer contributions on behalf of the MIPC. This benefit is financed on a Pay-As-You-Go basis from the General Fund of the Commonwealth of Puerto Rico (see Note 11).

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Net Position/Fund Balance

A) Net Position

Net position represents the difference between assets, deferred outflows of resources, liabilities, and deferred inflows of resources in the government-wide financial statements.

The GWFS utilize a net position presentation, which are categorized as follow:

- *Net Invested in Capital Assets* – These consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of notes payable and other debts that are attributed to the acquisition, construction or improvements of those assets. For Governmental Activities, net investment in capital assets is comprised only on Capital Assets, Net of Accumulated Depreciation. No Outstanding Balance on Related Debt or Unspent Capital Debt Proceeds exists.

- *Restricted Net Position* – These results when constraints placed on net position use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

- *Unrestricted Net Position* – These consist of net position which do not meet the definition of the two preceding categories. Unrestricted net position often is designated, to indicate that management does not consider them to be available for general operations. Unrestricted net position often has constraints on resources that are imposed by management, but can be removed or modified.

Net Position Flow Assumption

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

B) Fund Balance

Beginning with fiscal year 2011, the Office implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* This Statement provides more clearly defined fund balance categories to make the nature and extent of the constraints placed on a government's fund balances more transparent. The following classifications describe the relative strength of the spending constraints:

- Nonspendable – amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.

- Restricted – amounts constrained to specific purposes by their providers (such as grantors), through constitutional provisions, or by enabling legislations.

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

continue

NOTE 1 – ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

NOTE 2 – CASH AND CASH EQUIVALENTS

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

During the year, the Office invests its funds in interest bearing bank accounts. The Office is authorized to deposit only in institutions approved by the Department of the Treasury of the Government of Puerto Rico. Such deposits should be kept in separate accounts in the name of the Office. Under Puerto Rico statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of the amounts insured by the Federal Deposit Insurance Corporation. During the year ended June 30, 2020, the Office invested its funds in bank accounts bearing interest.

The Office follows the provisions of GASB Accounting Standards Codification Section C20, *Cash Deposit with Financial Institutions*, related with cash deposit and interest-earning investment contract with financial institutions. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of the Office on June 30, 2020:

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2020, the Office has invested only in cash equivalents of $10.4 million consisting of interest-bearing account in commercial banks, which are insured by the FDIC, generally up to a maximum of $250,000. As previously mentioned, public funds deposited by the Office in commercial banks must be fully collateralized for the amounts deposited more than the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2020. Therefore, the Office's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Office's deposits is considered low on June 30, 2020.

Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the Office 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 Government adopted by FAFAA, the Office may invest in obligations of the Government, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by GDB. On June 30, 2020, the Office has balances deposited in commercial banks amounting to $10,356,291 are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Therefore, the Office's management has concluded that on June 30, 2020, the custodial credit risk associated with the Office's cash and cash equivalents is considered low.

continue

NOTE 2 – CASH AND CASH EQUIVALENTS – continuation

Interest Rate Risk

This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. the Office manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio on June 30, 2020, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of four months or less, and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. Therefore, on June 30, 2020, the interest risk associated with the Office's cash and cash equivalent is considered low.

Foreign Exchange Risk

This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. According to the aforementioned investment guidelines, adopted by the Office, the Office is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the Office's deposits is considered low on June 30, 2020.

NOTE 3 – INTERGOVERNMENTAL ACCOUNTS RECEIVABLE

Intergovernmental account receivables from governmental entities totaled $37,509 from the Senate of Puerto Rico, $37,880 from the House of Representatives and $1,988 from the Superintendent of the Capitol.

NOTE 4 – INVENTORY

Inventories in the Governmental Fund Financial Statements have been recorded using the consumption method and are stated at the lower of cost (first-in, first out method) or market. Inventories consist primarily of supplies held for consumption for the Office.

The Office uses the purchase method of accounting where purchases of inventories are recognized as expenditures when the goods are received, and the transaction is vouched. Generally accepted accounting principles allows the purchase method to account for inventories but concludes that when the inventory amount is significant, the amount must be reported in the government's fund balance sheet. An estimated value for inventories is reported as both, an asset and a fund balance reserve in the General Fund.

Description	Location	Valuation
Office Materials	OSL Office	$ 27,792
Maintenance Materials	OSL Office	551
Medical Supplies	Capitol Building	13,434
		$ 41,777

continue

NOTE 5 – DUE TO GOVERNMENTAL UNITS

Due to governmental units on June 30, 2020 are summarized as follows:

Puerto Rico Treasury Department	$	52,297
State Insurance Fund Corporation		8,502
Asociación de Empleados de ELA		30,046
Office of the Superintendent of the Capitol Building		4,076
TOTAL	$	94,921

NOTE 6 – CAPITAL ASSETS

Description	Balance at June 30, 2019	Adjustments	Additions	Retirements & Adjustments	Balance at June 30, 2020
Governmental Activities:					
Capital Assets:					
Equipment	$ 409,886	$ -	$ -	$ (1,281)	$ 408,605
Computer Equipment	1,015,158	-	-	(1,045)	1,014,113
Library	25,179	-	-	-	25,179
Improvement to Facilities	92,475	-	-	-	92,475
Furniture	491,986	-	1,951	(18,920)	475,017
Vehicles	101,731	-	-	-	101,731
Intangibles	-	-	-	-	-
Total Depreciable Capital Assets	**2,136,415**	**-**	**1,951**	**(21,246)**	**2,117,120**
Less: Accumulated Depreciation					
Equipment	(279,649)	-	(1,234)	1,281	(279,602)
Computer Equipment	(836,897)	-	(42,295)	1,045	(878,147)
Library	(23,693)	-	(30,840)	-	(54,533)
Improvement to Facilities	(79,772)	-	(8,560)	-	(88,332)
Furniture	(264,868)	-	(53,116)	18,920	(299,064)
Vehicles	(77,912)	-	(9,530)	-	(87,442)
Intangibles	-	-	-	-	-
Total Accumulated Depreciation	**(1,562,791)**	**-**	**(145,575)**	**21,246**	**(1,687,120)**
CAPITAL ASSETS, NET	**$ 573,624**	**$ -**	**$ (143,624)**	**$ -**	**$ 430,000**

Depreciation expenses of Governmental Activities were charged to general governmental function for the fiscal year ended June 30, 2020.

NOTE 7 – DEFERRED OUTFLOWS / INFLOWS OF RESOURCES

Pursuant to GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* the Office recognized deferred outflows of resources in the government-wide and fund statements. These items are a consumption of net position by the Office that is applicable to a future reporting period. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities. The Office has items that are reportable on the Government-wide *Statement of Net Position* that are relates to outflows/inflows from changes in the Net Pension Liability (Note 10).

continue

NOTE 7 – DEFERRED OUTFLOWS / INFLOWS OF RESOURCES – continuation

Under the modified accrual basis of accounting, it is not enough that revenue is earned; it must also be available to finance expenditures of the current period. Governmental funds *Balance Sheet* report *Deferred Inflows of Resources* in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period (unavailable). Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned.

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

Government-wide:	**Governmental Activities**
Deferred Outflows of Resources	
Contributions to ERS	$ 917,358
Deferred Inflows of Resources	
Unamortized Investment in ERS	$ 4,185,361

NOTE 8 – LONG-TERM OBLIGATIONS

The liabilities reported as June 30, 2020 in the government-wide financial statements was as follows:

	Balance at June 30, 2019	Increase	Decrease	Balance at June 30, 2020	Due within One (1) Year	Due after One (1) Year
Compensated Absences	$ 1,188,332	$ 211,525	$ (19,323)	$ 1,380,534	$ 119,012	$ 1,261,522
Net OPEB Liability	460,694	-	-	460,694	-	460,694
Net Pension Liability	6,981,282	-	-	6,981,282	-	6,981,282
TOTAL	$ 8,630,308	$ 211,525	$ (19,323)	$ 8,822,510	$ 119,012	$ 8,703,498

NOTE 9 – INTERGOVERNMENTAL REVENUES

Intergovernmental revenues consist primarily of funds received from the Government of Puerto Rico. Intergovernmental revenues are accounted for through the General Fund and Special Assignments Fund because they are not restricted for specific purpose.

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN

As further described in Note 1, the Office implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pension*, during fiscal year 2018, and a new Required Supplementary Information schedules are included herein. Also, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, an amendment to GASB No. 68, is implemented simultaneously with the provisions of GASB No. 68.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Description of the Plan

Prior to August 23, 2017 the Employee's Retirement System of the Government of the Commonwealth of Puerto Rico (ERS) implemented a cost-sharing multi-employer defined benefit pension plan administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration. Employees of the Office participate in the ERS. The ERS is a trust created by Act No. 447, approved on May 15, 1951, as amended (Act No. 447-1951) 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). Membership is optional for the Governor, Government secretaries, head of public agencies, and instrumentalities, among others. 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, 2016, membership of the ERS consisted of the following:

Retirees and beneficiaries currently receiving benefits	108,035
Current participating employees – defined benefit	53,832
Current participating employees – System 2000 and Act No. 3-2013	64,825
Disabled members, receiving benefits	14,722
Total Membership	241,414

Pension Benefits

Pension benefits provided to members of the System are established by Commonwealth law and may be amended only by the Legislature with the Governor's approval. Act No. 3-2013, in conjunction with other recent funding and design changes, provided for a comprehensive reform of the System. This summary details the provisions under Act No. 3-2013.

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

- Members of Act No. 447-1951 are generally those members hired before April 1, 1990 (Contributory, Defined Benefit Program)
- Members of Act No. 1 are generally those members hired on or after April 1, 1990 (Act No. 1-1990) and on or before December 31, 1999 (Contributory, Defined Benefit 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 Contributory 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 Defined Contribution Hybrid Program, and were rehired on or after July 1, 2013, become members of the Defined Contribution Hybrid Program as a condition to their employment. In addition, employees who on June 30, 2013, were participants of previous programs will become part of the Contributory Hybrid Program on July 1, 2013.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Each member has a non-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 Government does not guarantee benefits at retirement age.

The assets of the Define Benefit Program, the Defined Contribution Program and the Contributory Hybrid Program were pooled and invested by the ERS.

a) **Retirement Annuity** – Plan members are eligible for a retirement annuity based on years of service, final average compensation and retirement age. Plan members are eligible for monthly benefit payments determined by the application of stipulated benefit ratios to the plan member's average compensation.
b) **Average Compensation** – Is computed based on the highest 36 months of compensation recognized by the System. The annuity, for which a plan member is eligible, is limited to a minimum of $400 per month and a maximum of 75% of the average compensation.
c) **Merit Annuity** – Plan members are eligible for merit annuity with a minimum of 30 years or more of credited service. The annuity for which the plan member is eligible is limited to a minimum of 65% and a maximum of 75% of the average compensation.
d) **Deferred Retirement Annuity** – A participating employee who ceases to be an employee of the Commonwealth after having accumulated a minimum of 10 years of credited service qualifies for retirement benefits provided his/her contributions to the System are not withdrawn until attainment of 58 years of age.
e) **Coordinated Plan** – On this plan, the participating employee contributes a 5.775% of the monthly salary for the first $550 and 8.275% for the excess over $550. By the time the employee reaches 65 years old and begins to receive social security benefits, the pension benefits are reduced.
f) **Non-Coordinated Plan** – On this plan, the participant employee contributes an 8.275% of the monthly salary and does not have any change on the pension benefits upon receiving social security benefits.
g) **Reversionary Annuity** – A plan member, upon retirement, could elect to receive a reduced retirement annuity giving one or more benefit payments to his/her dependents. The life annuity payments would start after the death of the retiree for an amount not less the $240 yearly or greater than the payments being received by the retiree.
h) **Occupational Disability Annuity** – A participating employee, who as a direct result of the performance of his/her occupation is totally and permanently disabled, is eligible for a disability annuity of 50% of the compensation received at the time of the disability.
i) **Non-Occupational Disability Annuity** – A participating employee totally and permanently disabled for causes not related to his/her occupation, and with no less than 10 years of credited service, is eligible for an annuity of 1.5% of the average compensation of the first 20 years of credited services increased by 2% for every additional year of credited service in excess of 20 years.
j) **Death Benefits-Occupational** – The surviving spouse is eligible for an annuity equal to 50% of the participating employee's salary at the date of the death. Children are eligible for an annuity of $10 per month for each child, minor or student, up to a maximum benefit per family of 100% of the participating employee's salary at the date of the death. If no spouse survives, or dies while receiving the annuity payments, each child, age 18 or under, is eligible to receive an annuity of $20 per month up to the attainment of 18 years of age or the completion of his/her studies.
k) **Death Benefits-Non-Occupational** – The beneficiary if eligible to receive the contributions and interest accumulated as of the date of the death plus an amount equal to the annual compensation at the time of the death. Beneficiary with surviving spouse age 60 or over and child, age 18 or under, up to 50% (60%, if not covered under the Title II of the Social Security Act) of retiree's pension or otherwise the excess, if any, of the accumulated contributions at the time of retirement over the total annuity benefits received before death, limited to a minimum of $1,000.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Other benefits granted by the Commonwealth to the System's retirees during fiscal years 2003 and 2007 included Christmas bonus, summer bonus, medication bonus and cost of living adjustment for pension benefits (COLA).

The Act No.1-1990 made certain amendments applicable to new participants joining the pension plan effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participant who have completed 30 years of creditable service.

Adoption of Comprehensive Reform of Employees Retirement System

On April 4, 2013, the Governor of Puerto Rico signed into law Act No. 3 ("Act No. 3-2013"), which adopted a comprehensive reform of the Employees Retirement System of the Commonwealth (ERS System).

Act No. 3-2013, which is effective on July 1, 2013, provides the following:

a) It freezes and grandfathers the benefits that have accrued through June 30, 2013 of those participants who are covered by the ERS System's defined benefit formula (those who joined the ERS System prior to January 1st, 2000, whose retirement benefits accrued at a rate of 1.5% or 2% per year of creditable service;

b) It provides that, beginning on July 1st, 2013, the retirement benefits accruing on and after the Effective Date for defined benefit employees will be calculated based on a defined contribution formula, similar to the ERS System 2000 formula currently applicable to employees who joined the ERS System on or after January 1st, 2000, with all such benefits being paid in the form of a lifetime annuity rather than a lump sum payment (upon retirement). The employee will receive the benefits accrued through June 30, 2013 based on the defined benefit formula plus the contributions made by the employee after June 30, 2013;

c) It provides that defined contribution benefits accrued pursuant to ERS System 2000 will also be paid in the form of a lifetime annuity rather than a lump sum payment;

d) It eliminates the so called "merit pension" that provided to participants who joined the ERS System prior to April 1, 1990, after attaining 30 years of service, a retirement benefit of 65% (if less than 55 years of age) or 75% (if age 55 or greater) of the average salary earned during the highest 36 months of employment;

e) It increases the retirement age for various groups as follows: (a) from 58 to age 61 for Act No. 447-1951 participants and: (b) from 60 to age 65 for active system 2000 participants;

f) It increases the employee contributions to the ERS System from 8.275% to 10%;

g) It eliminates or reduces various retirement benefits previously granted by special laws, including Christmas and summer bonus;

h) It increases the minimum pension from $400 to $500 per month for current retirees and;

i) It eliminates or modifies other benefits such as disability and survivor benefits

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Contributions requirements, based on gross salary, are established by law and are as follows:

House of Representatives

Fiscal year ended June 30:

2017	15.525%
2018	16.775%
2019	18.025%
2020	19.275%
2021	20.525%

Participants:

Hired on or before March 31, 1999	5.775% of gross salary up to $6,600
	8.275% of gross salary over $6,600
Hired on or after April 1, 1990	8.275% of gross salary

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 2015. 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 Government 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 Government's General Funds, since the Government is the primary sponsor and is obligated to make contributions to fund each of the ERS.

The Government 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 Government's public-sector debt, the continued downgrading of the Government'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 Government 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 Government'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. 32-2013), 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.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

To improve the liquidity and solvency of the ERS, the Government enacted Act No. 32-2013, as amended by Act No. 244-2014, which provides for incremental annual contributions (Additional Uniform Contribution) from the Government's General Fund, public corporations and municipalities beginning in fiscal year 2014 and up to the fiscal year 2033. The AUC determined for fiscal year 2014 was defined as $120.0 million and subsequent annual amounts will be determined annually based on actuarial studies to be performed by the ERS's actuaries as necessary for the ERS's gross assets to remain above $1.0 billion. An appropriation for such AUC of approximately $98 million was included in the Government's budget for the fiscal year 2014. However, as a result of the Government's General Fund revenue shortfall, compared to budget, the Government made certain adjustments to the fiscal year 2014 budgetary appropriations following the "priority norms" for the disbursement of public funds that apply during any fiscal year in which the resources available to the Government are insufficient to cover the appropriations approved for such year. These adjustments included the reduction in full of the portion of the Act No. 32-2013 AUC by executive Order No. 29-2014.

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. 32-2013, 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 Government and other participating employers have not been unable to make the AUC required in full for these fiscal years (other than $34.4 million paid by such municipalities and public corporations for fiscal year 2014 and $22.7 million paid by the Government 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 Government 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 Government, to be funded from its General Fund, and the remaining portion corresponds to the participating public corporations and municipalities).

Pension Liabilities, Pension Expenses, and Deferred Outflows/Inflows of Resources Related to Pensions

(1) Net Pension Liability

The Office 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 was measured as of June 30, 2015, 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, 2017 rolled forward to June 30, 2018 using standard update procedures. the Office's proportion of the Net Pension Liability was based on a projection of the Office's long-term share of contributions to the pension plans program relative to the projected contributions of all participating employers, actuarially determined. As June 30, 2017, the Office's proportional share was 0.02040%, according to the audited report issued by the ERS on June 30, 2017. The Office's proportionate share of the Net Pension Liability was as follows:

Proportion - June 30, 2017	0.02040%
Proportion - June 30, 2016	0.02142%
Change - Increase (Decrease)	-0.00102%

As of June 30, 2018, the Office reported $6,981,282 as Net Pension Liabilities for its proportionate shares of the Net Pension Liabilities of ERS as follows:

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Net Pension Liability	June 30, 2018 TOTAL	Proportional Share (.02040%)
Total Pension Liability	$ 32,109,294,000	$ 6,551,023
Fiduciary Net Position (Deficit)	(2,108,880,000)	(430,259)
Net Pension Liability	$ 34,218,174,000	$ 6,981,282
Plan's Fiduciary Net Position (Deficit) of Total Pension Liability	-6.57%	-6.57%
Covered Payroll	$ 3,344,197,000	$ 682,292
Net Pension Liability as % of Covered Payroll	1023.21%	1023.21%

(2) Pension Expense

For the fiscal year ended June 30, 2020, the pension expense of the Office was recognized by the Commonwealth.

(3) Deferred Outflows/Inflows of Resources

As of June 30, 2020, the Office reported Deferred Outflows of Resources and Deferred Inflows of Resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	$ -	$ -
Difference Between Expected and Actual Experience in Measuring the Total Pension Liability	4,716	123,553
Changes in Assumptions	912,642	710,527
Change in Employer's Contributions and the Employer's Proportionate Share of	-	3,310,501
Net Differences Between Projected and Actual Earnings on Plan Investments	-	40,780
Total	$ 917,358	$ 4,185,361

Deferred outflows of resources and deferred inflows of resources above represent the unamortized portion of changes to net pension liability to be recognized in future periods in a systematic and rational manner. $917,358 reported as deferred outflows of resources related to pensions resulting from the Office contributions after the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2020.

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

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Year Ended June 30,	Amount
2019	$ 653,600
2020	653,600
2021	653,600
2022	653,600
2023	653,601

Actuarial Methods and Assumptions

The census data collection date has changed from end-of-year to beginning-of-year. For this switchover year, the June 30, 2017 are based on projecting the System obligations determined as of the census data collection date of July 1, 2016 for one year, using roll-forward methods and assuming no liability gains or losses.

The actuarial valuation used the following actuarial assumptions:

Inflation	N/A
Municipal Bond Index	3.58%m as per Bond Buyer General Obligation 20-Bond Municipal Bond Index
Projected Salary Increase	3.00%per year. No compensation increases are assumed until July, 1, 2021 as a result of Act No. 3-2017 and the current general economy.
Mortality	Pre-retirement Mortality - For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. For members covered under Act No. 127, RB-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Sclae MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127.
	Pot-retirement Healthy Mortality - Rates which vary by gender are assumed for healthy retirees and beneficiaries based on study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 mortality Tables for Males and 95% of the rates from UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projectded using mortality improvements both before and after measurement date.
	Post-retirement Disabled Mortality - Rates which vary by gender are assumed for disabled retirees based on a study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2017 on a generational basis. As a Generational table, it reflects mortality improvements both before and after the measurement date.

Most other demographic assumptions used in the July 1, 2014 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.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

Long-Term Expected Rate of Return

The long-term expected rate of return on pension benefits investments was not applicable as of June 30, 2017. Net assets are negative as of June 30, 2017 and accordingly, it is not possible to determine a rate of return on net assets during the fiscal year. In addition, after June 30, 2017, due to the Pay-As-You-Go System by which the Government guarantees payment of pensions. The System assets were no longer necessary to generate investment returns to pay pension benefits. The approximate actual rate of return on gross assets was 8.74% as of June 30, 2017.

Before June 30, 2017, the pension plan's policy for allocation of invested assets has been established and may be amended by the System's Board of Trustees. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through the pension programs. The following asset allocation policy as of June 30, 2017 was adopted by the System's Board of Trustees:

Asset Class	Target Allocation	Long-Term Expected Rate of Return
Domestic Equity	56%	N/A
International Equity	15%	N/A
Fixed Income	28%	N/A
Cash	1%	N/A
Total	100%	

In prior years, the long-term expected rate of return on pension benefits investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. This year, the long-term expected rate of return assumption is no longer applicable.

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 expected to be exhausted in the fiscal year 2015.

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 tax free municipal bond index (Bond Buyer General Obligation 20-Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine the total pension liability. The discount rate was 3.58% as of June 30, 2017.

The June 30, 2017, actuarial valuation reflects a decrease of $5,498 million in the net pension liability, rate as required by GASB Statement No. 67 from 2.85% in fiscal year 2016 to 3.58% in fiscal year 2017, and the effect of plan changes of approximately $2,017 million.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

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

	June 30, 2016	June 30, 2017
Discount Rate	2.85%	3.58%
Long-term expected rate of return net of investment expense	6.55%	N/A
Municipal bond rate *	2.85%	3.58%
* Bond Buyer General Obligation 20-Bond Municipal Bond Index		

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

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

The following presents the House of Representative's proportionate share of the Net Pension Liability on June 30, 2017, calculated using the discount rate of 3.58%, as well as what the House of Representative's proportionate share of 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:

	At 1% Decrease 2.58%	At current Discount Rate 3.58%	At 1% Increase 4.58%
Net Pension Liability	$ 7,916,464	$ 6,981,282	$ 6,228,339

Information for June 30, 2020 is not available at the date of the financial statements are ready to be issue.

Medical Insurance Plan for Retired Employees

There are no member or employer contributions on behalf of the Medical Insurance Plan Contribution. This benefit is financed on a pay-as-you-go basis from the General Fund of the Government 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 2.90% based on the asset allocation on the Government general assets that are used to pay this benefit.

As a cost-sharing multiple employer plan, ERS is not required to report a Net OPEB Liability. In accordance with paragraph 23 of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, the employers that participate in the plan should recognize annual OPEB expense equal to their contractually required contributions to the plan. The employers do not have an ARC or a Net OPEB Liability.

Fiscal Plan for Puerto Rico

The Fiscal Plan for Puerto Rico was approved by the Oversight Board of PROMESA (see Note 15) on May 27, 2020. The approval was conditioned on the Puerto Rico government and the Board reaching an agreement to reduce benefit payments of the following systems by 8.5% for higher pensions in the aggregate:

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

- 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.

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.

continue

NOTE 10 – EMPLOYEE'S RETIREMENT PLAN – continuation

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

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

Pension Plan Fiduciary Net Position

As per June 30, 2017 Actuarial Valuation Report issued on November 9, 2020, the Actuaries state: "*PRGERS net assets became negative in the 2014-2015 fiscal year PRGERS gross assets as June 30, 2017 are less than one year of expected benefit payments*."

The Employee's Retirement System of the Government of the Government 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 Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

NOTE 11 – OTHER POSTEMPLOYMENT BENEFITS (OPEB)

In addition to the pension benefits described in Note 10 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 Office accounts for OPEB under the provisions of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, that replaces GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, changes similar to those implemented on GASB No. 67, *Financial Reporting for Pension Plans*, and No. 68, *Accounting and Financial Reporting for Pensions* should be made. This statement has substantially revised the accounting requirements previously mandated under GASB Statements No. 43 and 45. The most notable change is that the Annual Required Contribution (ARC) has been eliminated and the Net OPEB Liability will be an item on the employer's financial statement rather than a footnote entity.

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

continue

NOTE 11 – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

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

Christmas Bonus Benefits

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

Funding Policy – the contribution requirement of ERS MIP, are established by Act No. 95-1963. Its benefit consists of a maximum of $100 per month per retiree or disabled member. There are no member or employer contributions on behalf of the MIPC. These benefits are financed on a Pay-As-You-Go basis from the General Fund of the Commonwealth of Puerto Rico and municipalities.

Relationship Between Valuation Date, Measurement Date, and Reporting Date

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

Significant Changes

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

Deferred Inflows and Outflows

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

Total OPEB Liability

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

Total OPEB Liability	June 30, 2017	
	Total	Proportional Share (0.04316%)
Total OPEB Liability	$ 1,067,502,659	$ 460,695
Covered Payroll	N/A	N/A
Total OPEB Liability as a % of Covered Payroll	N/A	N/A

continue

NOTE 11 – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

The Office's proportionate share of the Net Pension Liability used was as follows:

Proportion - June 30, 2016	0.04009%
Proportion - June 30, 2017	0.04316%
Change - Increase (Decrease)	0.00307%

Discount Rate

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

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

As of June 30, 2020, 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 Office with the audited schedules of employment allocations and OPEB amounts by employer as of June 30, 2020 (Office's measurement date), necessary to comply with the requirements of GASB Statement No. 75 *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions,* as of June 30, 2020. 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.

Changes in Net Pension Liability	Total Pension Liability	Proportional Share
Balance as of June 30, 2016	$ 1,374,395,292	$ 593,139
Changes for the year:		
Service Cost	-	-
Interest on Total Pension Liability	37,890,871	16,352
Effect of Plan Changes	-	-
Effect of Economic/Demographic (Gains) or Losses	(13,831,526)	(5,969)
Effect of Assumptions Changes or Inputs	(240,534,656)	(103,806)
Benefits Payments	(90,417,322)	(39,021)
Balance as of June 30, 2017	**$ 1,067,502,659**	**$ 460,695**

continue

NOTE 11 – OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

Actuarial Methods and Assumptions

Valuation Date	July 1, 2016
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry Age Normal
Medical Trend Rate	Not Applicable
Mortality	Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2000 Employee Mortality Rates for males and females projected on a generational basis using Scale AA. For members covered under Act No. 127, RP-2000 Employee Mortality Rates with blue collar adjustments for males and females, projected on a generational basis using Scale AA. As generational tables, they reflect mortality improvements both before and after the measurement date. 100.0% of deaths while in active service are assumed to be occupational for members covered under Act No. 127. Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females. The rates are projected on a generational table, it reflects mortality improvements both before and after the measurement date. Post-retirement Disabled Mortality: Rates which vary by gender are assumed fordisabled retirees based on a study of plan's experience from 2007 to 2012 equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. No provision was made for future mortality improvement for disabled retirees.

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

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

	1% Decrese 2.58%	Current Discount Rate 3.58%	1% Increse 4.58%
Total OPEB Liability	**$ 506,926**	**$ 460,695**	**$ 421,609**

continue

NOTE 12 – COMMITMENTS AND CONTINGENCIES

Operating Leases

Rent expense under such lease agreements for the fiscal year ended June 30, 2020 amounted to approximately to $135,058.

Litigation – the Office

According to the laws of the Government of Puerto Rico, the Office is fully represented by the Puerto Rico Department of Justice in defense of all legal cases. Any claims with negative financial impact would be paid from the General Fund of the Government of Puerto Rico, with no effect on the budget or resources of the Office.

NOTE 13 – COMPONENTS OF FUND BALANCES

Fund balances are presented in the following categories: nonspendable, restricted, committed, assigned, and unassigned (see Note 1 for a description of these categories). A detailed schedule of fund balances on June 30, 2020 is as follows:

	GENERAL FUND	SPECIAL REVENUE FUND	TOTAL FUNDS
Nonspendable:	$ 30,545	$ 11,232	$ 41,777
Restricted For:			
General Goverment and Interships	-	3,589,219	3,589,219
Total Restricted	-	3,589,219	3,589,219
Committed To:			
Total Committed	-	-	-
Assigned To:			
Total Assigned	-	-	-
Unassigned	6,148,051	-	6,148,051
Total Fund Balances	**$ 6,178,596**	**$ 3,600,451**	**$ 9,779,047**

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

continue

NOTE 14 – GOING CONCERN – PRIMARY GOVERNMENT

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

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

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

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

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

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

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

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

NOTE 14 – GOING CONCERN – GOVERNMENT OF PUERTO RICO – 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.

PUERTO RICO FILES FOR BANKRUPTCY UNDER PROMESA TITLE III

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

Both the Oversight Board and the New Government Administration have expressed a strong preference for restructuring the Government' debt through the use of Title VI. However, when the it comes to the debt of the Government 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 Government 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 Government, asserted claims against the Government 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
(vi) Agency Efficiencies Measures
(vii) Healthcare Reform

continue

NOTE 14 – GOING CONCERN – GOVERNMENT OF PUERTO RICO – continuation

(viii) *Tax Compliance and Fees Enhancement*
(ix) *Reduction in UPR and Municipality Appropriations*
(x) *Pension Reform*
(xi) *Fiscal Controls and Transparency*

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

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

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA)

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

PROMESA Overview

Background

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

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

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

NOTE 15 – 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

NOTE 15 – 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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

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

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

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

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

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

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

Fiscal Plan – 2019

On January 18, 2019, the Oversight Board requested the Governor to submit another 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 Hacienda, as well as a liquidity facility of up to $185 million for municipalities suffering from revenue collection deferrals.

continue

NOTE 15 – 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.

continue

NOTE 15 – 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.35 The youth unemployment rate is equally high—24.7%—roughly double the world average (12.7%) and three times the US average (8.4%).36 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.

continue

NOTE 15 – 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:**
  - ⇨ Hacienda: Transferring EITC promotional responsibilities to ADSEF
  - ⇨ ADSEF: Designing a multifaceted EITC outreach strategy (including working with community organizations throughout the Island)

- **Introduce a Nutritional Assistance Program (NAP) Work/Volunteer Requirement by:**
  - ⇨ ADSEF: Creating a work/volunteer requirement compliant with Certified Fiscal Plan parameters
  - ⇨ ADSEF: Completing all administrative requirements (e.g. obtaining Federal Government approval) necessary to implement a work/volunteer requirement
  - ⇨ ADSEF: Verifying the eligibility of all adult NAP recipients for the new work/volunteer requirement

- **Create High-Quality Workforce Development Programs by:**
  - ⇨ DDEC: Creating partnerships with private and social sector organizations to strengthen worker training
  - ⇨ DDEC: Conducting regular analyses to understand private sector labor market needs
  - ⇨ DDEC & Vivienda: Allocating resources in a data-driven manner
  - ⇨ DDEC: Removing structural barriers to employment (e.g. difficult in securing transportation and childcare to go to work)

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.

continue

NOTE 15 – 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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Ease of Doing Business Reform (Chapter 10)

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

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

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

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

In the 2018 and 2019 Ease of Doing Business Report, Puerto Rico was ranked 64th. This represents a 9-point decline from 2017 and is 58 spots lower than the U.S., which ranks 6th overall. While the overall ranking did not change in 2019, the underlying trends on the most critical improvements needed to encourage growth in Puerto Rico were negative – such as getting electricity, construction permitting, and registering property. There are some areas of strength: Puerto Rico placed 6th for Getting Credit and 9th for Resolving Insolvencies. It has also made recent efforts to digitize government services to improve speed and accessibility, having launched the Single Business Portal (SBP) in July 2018, which currently includes online filing system for defined Acts (Acts 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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- **Registering Property:** Companies must invest significant amounts of time (190 days) and effort (eight procedures), on average, to register property
- **Paying Taxes:** Firms spend significant time (218 hours) completing filings (16 payments), on average, and are much likelier to be audited than on the mainland
- **Occupational Licensing Laws:** Excessive regulations have restricted labor force participation and constrained economic activity
- **Freight Regulations:** Inefficient regulations have inflated transportation costs for businesses across the Island
- **Offshore Investment Attraction:** Inadequate Government oversight and resourcing have inhibited efforts to attract investments
- **Tourism Attraction:** Insufficient Government funding and a narrow mandate undermine the Destination Marketing Organization's efforts to transform Puerto Rico into a leading tourist destination

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

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

Power Sector Reform (Chapter 11)

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

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

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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.171 PREPA also significantly underperforms against mainland utilities on multiple operational, reliability, and customer service metrics:

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

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

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

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

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

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

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

Infrastructure Reform (Chapter 12)

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

Current State of Infrastructure and Capital Investment

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Transforming Government to Better Serve the Island

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

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

Agency Efficiencies (Chapter 13)

In accordance with Section 201(b)(1) of PROMESA, the Fiscal Plans for Puerto Rico "provide a method to achieve fiscal responsibility and access to the capital markets." When the Fiscal Plan process began in 2017, the Government had approximately ~116,500 employees across 114 Executive Branch government agencies, as well as agencies within the Legislative and Judicial branches (excluding large instrumentalities, e.g., PREPA, PRASA, HTA UPR, COSSEC, GDB).196,197 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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

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

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

To achieve personnel savings, the Government has primarily utilized broad-based early or incentivized retirement programs (e.g., the Voluntary Transition Program and Voluntary Pre-Retirement Program (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).

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

The core objectives of the consolidated OCFO must be to:

A) Centralize treasury and liquidity management to:

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

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

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

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

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

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

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

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

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

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

  - Administer cash management programs to invest surplus cash

  - Facilitate short- and long-term borrowing programs

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

  - Oversee all tax decrees and agreements issued

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Medicaid Investments and Reform (Chapter 15)

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

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

Because federal Medicaid funding for US territories is subject to an annual cap, Medicaid expenditures eligible for federal matching exceed available funding without supplemental legislated sources. This makes Puerto Rico's Medicaid program very sensitive to rising healthcare costs. Since 2011, Puerto Rico has received temporary relief from rising healthcare costs through increased levels of federal reimbursement made available through the passage of the Affordable Care Act and the Bipartisan Budget Act of 2018. In December 2019, the Further Consolidated Appropriations Act was passed, which provided supplemental federal funding (up to $5.7B total) to Puerto Rico's Medicaid program through September 30, 2021 (first quarter in FY2022). In addition, the law raised the FMAP—the portion of Medicaid expenditures that federal funds can cover—from the standard level of 55% to 76% for most populations. In response to the COVID-19 pandemic, the Families First Coronavirus Response Act was passed in March 2020, further increasing both the available federal funds (adding an additional $183M) and the FMAP (increased an additional 6.2% for most populations). The available supplemental federal funds and higher FMAP will both return to standard levels in October 2021 without new federal legislation. Accordingly, the Commonwealth will hit a "Medicaid fiscal cliff," whereby it will be responsible for multi-billion-dollar annual healthcare expenditures that had been covered by federal funding since 2011. It is crucial, therefore, that ASES take advantage of the additional runway provided by recent federal legislation to put in place reforms that reduce the long-term growth rate of healthcare expenditures. Given the uncertainty as to future federal reimbursement levels, the 2020 Fiscal Plan assumes that no further supplemental funding will be provided beyond current programs, and thus, the Commonwealth must be prepared to cover growing Medicaid costs as if federal reimbursement rates 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 2013.256 This has allowed for persistent problems with non-compliance, worsened by a lack of an integrated approach to addressing non-compliance. Top marginal tax rates are high relative to US federal and state taxes. Much of the Government's revenue is highly concentrated in collections from a handful of multi-national corporations. The Government has also issued an assortment of credits, deductions, and incentives that add to the system's complexity and further erode the tax base. Furthermore, audit and enforcement activity in recent years has been limited, which creates risks of increased levels of non-compliance.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

In response to these challenges, the Government has taken actions to improve tax compliance. It has taken steps to improve information reporting to better detect under-reporting of income and over-usage of deductions and credits, notably through recent changes to information reporting requirements included in Act 257-2018. These changes create greater interdependencies among taxpayers and the information they are obligated to report, which is expected to enable greater oversight and verification of the information being reported to the Government. Enhanced usage of data can help Hacienda better isolate risk and focus its compliance and enforcement resources. It is driving improvements in its culture and organization to boost enforcement capabilities, and digitizing the process of filing taxes, to lighten the burden of compliance on taxpayers.

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

Improve Compliance Rate

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

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

Right-rate Other Taxes and Fees

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

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

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

Reduction in Appropriations to UPR (Chapter 17)

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

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

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

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

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

Moreover, municipalities have made little (if any) progress towards implementing the fiscal discipline required to reduce reliance on Commonwealth appropriations and better reflect a declining population in many areas. The lack of fiscal management is now being exacerbated by the COVID-19 pandemic, threatening the ability of municipalities to provide necessary services, such as health, sanitation, public safety, and emergency services, to their residents and forcing them to prioritize expenditures.

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

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

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

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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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.

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

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

COVID-19 Crisis

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

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

Liquidity Facility

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

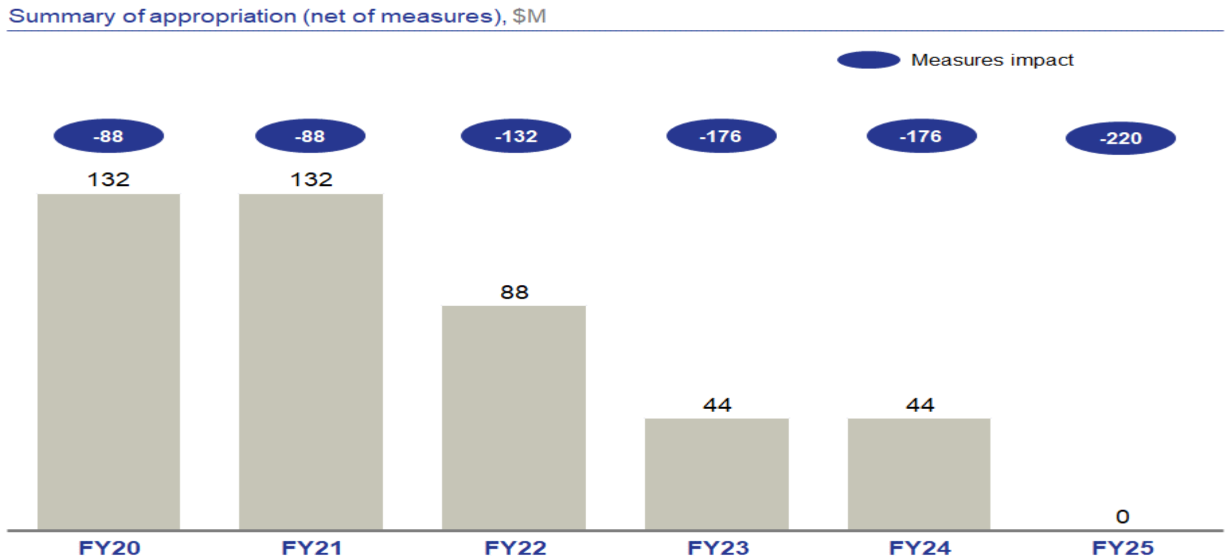
Incentivizing Consolidation of Services

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.

continue

NOTE 15 – 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

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- 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).

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

EXHIBIT 124: DISTRIBUTION OF BENEFIT AMOUNTS BY RETIREMENT SYSTEM

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

Covering More Government Workers in Social Security

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

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

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

The 2020 Fiscal Plan includes the enrollment of teachers and judges under the age of 45 in Social Security as of July 1, 2021, coincident with the plan freeze. At a further date, the Commonwealth may wish to take the necessary steps to provide the option for teachers and judges over the age of 45 to be covered under Social Security.

Ensuring Successful Implementation and Fiscal Controls (Chapter 20)

Developing a centrally-run PMO is an important step toward ensuring the implementation and tracking of the core operational transformation and agency efficiency measures that will achieve savings targets under the 2020 Fiscal Plan. The OCFO should serve as the central PMO with defined reporting to the Governor of all economic and transformation measures. The PMO should be run by OCFO senior leadership, regularly coordinate across OMB and OARTH, work directly and frequently with Agency PMOs, and report directly into the Governor's office.

Individual Agency PMOs should be established with direct reporting to the OCFO PMO. Each agency head shall be responsible for developing and implementing a PMO structure that best fits their respective agency groupings. They are expected to coordinate across all agencies in their grouping, lead reforms for the grouping and be responsible for achieving their agency grouping savings targets. Through this PMO structure, the Government will be positioned to effectively manage and implement the 2020 Fiscal Plan. As such:

- Designated agency heads should lead the Agency PMOs and report directly to the OCFO
- Agency PMOs should undertake the required work to implement initiatives
- The daily activities of PMOs should be managed and undertaken by staff knowledgeable in the relevant subject matter areas, and assigned members meet regularly with PMO leadership to report on progress and facilitate necessary decision-making
- Agency PMOs shall be responsible for assembling a taskforce to: complete validation and definition of full scope of projects and priorities; finalize reporting tools and tracking responsibilities; and perform ongoing weekly tracking and reporting.

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.

continue

NOTE 15 – PUERTO RICO OVERSIGHT, MANAGEMENT, AND ECONOMIC STABILITY ACT (PROMESA) – continuation

- **Sub-measure dashboards** that provide "zoomed in" views of a specific sub-measure, display progress with details / commentary on project status, include agreed upon milestones / dates to track progress, and provide mitigation plans

- **Implementation monthly reports** that provide a more detailed perspective on progress, including several key reporting elements: a) headcount by regular and transitory with more details in specific agency cases, b) budget to actuals by cost category and concept, c) milestones progress, d) KPIs/leading indicators, e) achieved savings to date. These reports provide important codification of progress as well as context for monthly meetings where agencies, OCFO and Oversight Board representatives can hold meaningful discussions on progress, items at risk and ongoing mitigating activities

Plan Adjustment (Chapter 21)

On February 28, 2020, the Oversight Board filed an amended Plan of Adjustment for the Commonwealth, ERS, and PBA that proposed a comprehensive settlement between the Commonwealth and its creditors. This represented a significant advance in the ongoing efforts of Puerto Rico to exit bankruptcy, regain access to the capital markets, and begin the process of achieving a true economic recovery. In total, the Plan of Adjustment sought to achieve a nearly 70% reduction in the Commonwealth's total liabilities, a reduction in annual debt service to sustainable and affordable levels, and a substantial and reliable restoration of pensions. This plan followed extensive negotiations between the Oversight Board, Government, and various stakeholder groups, and sought to return the Commonwealth to a sustainable fiscal position, provide meaningful recoveries to creditors, and allow for the continued operation of Government services.

In light of the COVID-19 pandemic, the Oversight Board announced on March 21, 2020 that it would be seeking a motion to adjourn court proceedings on the Plan of Adjustment until further notice. Such action was taken so as to allow for the Government and Oversight Board to prioritize the health and safety of the people of Puerto Rico during this challenging time, and to better understand the economic and fiscal impact of the pandemic. The Oversight Board will continue to work collaboratively with the Government to find reasonable and meaningful financial and policy solutions that ensure the safety and well-being of the Island, while also still preserving prudent and sound fiscal policy.

Despite the adjournment in court proceedings, the Oversight Board remains committed to facilitating Puerto Rico's emergence from bankruptcy, while also recognizing the new realities facing the Island. It is a fact that certain Plan of Adjustment provisions, if enacted, would impact the primary annual surplus/deficit of the Commonwealth. The 2020 Fiscal Plan therefore incorporates all such provisions on the terms published in the February 28, 2020 Plan of Adjustment (as adjusted for the delay in any confirmation timing).

NOTE 16 – NET POSITION RESTATEMENT

The following schedule reconciles the June 30, 2019 Net Position, as previously reported to Beginning Net Position, as Restated, July 1, 2019, for Governmental Activities.

	Governmental Activities
Beginning Net Position, As Previously Reported, June 30, 2019	$ 4,024,378
Adjustments for Recognized Post-Employment Benefits	(460,694)
Beginning Net Position, As Restated July 1, 2019	$ 3,563,684

continue

NOTE 17 – NEW ACCOUNTING STANDARDS

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

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

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

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. The determination of when the liability is incurred should be based on the occurrence of external laws, regulations, contracts, or court judgments, together with the occurrence of an internal event that obligates a government to perform asset retirement activities. Laws and regulations may require governments to take specific actions to retire certain tangible capital assets at the end of the useful lives of those capital assets, such as decommissioning nuclear reactors and dismantling and removing sewage treatment plants. Other obligations to retire tangible capital assets may arise from contracts or court judgments. Internal obligating events include the occurrence of contamination, placing into operation a tangible capital asset that is required to be retired, abandoning a tangible capital asset before it is placed into operation, or acquiring a tangible capital asset that has an existing ARO.

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

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

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

GASB Statement No. 88, *Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

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

This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specifies in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debts.

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

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

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

- The requirements related to the effective date of Statement No. 87 and Implementation Guide No. 2019-3, reinsurance recoveries, and terminology used to refer to derivative instruments are effective upon issuance. As per GASB Statement No. 95 the effective date is postponed by additional 18 months.
- Reporting of intra-entity transfers of assets between a primary government employer and a component unit defined benefit pension plan or defined benefit other postemployment benefit (OPEB) plan are effective for fiscal years beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- The applicability of Statements No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68, as amended, and No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, to reporting assets accumulated for postemployment benefits are effective for fiscal years beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.

- The applicability of certain requirements of Statement No. 84, *Fiduciary Activities*, to postemployment benefit arrangements and those related to nonrecurring fair value measurements of assets or liabilities are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- The requirements related to the measurement of liabilities (and assets, if any) associated with AROs in a government acquisition are effective for government acquisitions occurring in reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Reporting by public entity risk pools for amounts that are recoverable from reinsurers or excess insurers are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Reference to nonrecurring fair value measurements of assets or liabilities in authoritative literature are effective for reporting periods beginning after June 15, 2020. As per GASB Statement No. 95 the effective date is postponed by additional one year.
- Terminology used to refer to derivative instruments are effective for reporting periods beginning after June 15, 2020.

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

GASB Statement No. 87, *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities.

DEFINITION OF A LEASE

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

LEASE TERM

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

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

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

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

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

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

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

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

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

SHORT-TERM LEASES

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

LESSEE ACCOUNTING

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

LESSSOR ACCOUNTING

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

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

CONTRACTS WITH MULTIPLE COMPONENTS AND CONTRACT COMBINATIONS

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

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

LEASE MODIFICATIONS AND TERMINATIONS

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

SUBLEASES AND LEASEBACK TRANSACTIONS

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

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

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

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

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

The Governmental Accounting Standards Board issued the following pronouncements that have effective dates after June 30, 2020. The Office is currently evaluating its accounting practices to determine the potential impact on the financial statements for the GASB Statements.

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

PPPS

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

APAS

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

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

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

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

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

continue

NOTE 17 – NEW ACCOUNTING STANDARDS – continuation

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

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

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

NOTE 18 – SUBSEQUENT EVENT

Management has evaluated subsequent events through May 27, 2021 which is the same date the financial statements were available to be issued.

END OF NOTES

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Required Supplementary Information

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SCHEDULE OF REVENUES AND EXPENDITURES – BUDGET AND ACTUAL – GENERAL AND SPECIAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

	Budget Amounts		Actual Amounts	
	Original	Final	(Budgetary Basis)	Variance
REVENUES:				
Intergovernmental	$ 4,971,280	$ 4,971,280	$ 4,971,280	$ -
Special Appropriations	750,000	750,000	750,000	-
Total Revenues	5,721,280	5,721,280	5,721,280	-
EXPENDITURES:				
Current:				
General Government - Administrative and Operating Activities	5,434,929	5,434,929	5,038,839	396,090
Intership Programs	284,400	284,400	284,400	-
Capital Outlays	1,951	1,951	1,951	-
Total Expenditures	5,721,280	5,721,280	5,325,190	396,090
Excess (Deficiency) of Revenues Over (Under) Expenditures	$ -	$ -	$ 396,090	$ 396,090

The notes to the Required Supplementary Information are an integral part of this Schedule.

1. RECONCILIATION OF BUDGET/ GAAP

The schedule presents comparisons of the legally adopted budget with actual data on a budget basis. Because accounting principles applied for purposes of developing data on a budget basis differ significantly from those used to present financial statements in conformity with GAAP, a reconciliation of perspective, timing, and basis of accounting differences in the net change in fund balance for the year ended June 30, 2020 is presented below for the general and special funds.

2. EXPLANATION OF DIFFERENCES BETWEEN BUDGETARY INFLOWS AND OUTFLOWS AND GAAP REVENUES AND EXPENDITURES

		General and Special Funds
Sources/Inflows of Resources:		
Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 110)	$	5,721,280
Difference – Budget to GAAP:		
Non budgetary items –		-
Total Revenues as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balances (See Page 24)	$	5,721,280
Uses/Outflows of Resources:		
Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 110)	$	5,325,190
Difference – Budget to GAAP:		
Non budgetary items – Expenditures of Savings from prior years (which are included on the General Fund)		5,505,414
Total Expenditures as Reported on the Statement of Governmental Funds Revenues, Expenditures and Changes in Fund Balances (See Page 24)	$	10,830,604

END OF NOTES

	2015	2016	2017	2018
Proportion of the Net Pension Liability*	0.01649%	0.02044%	0.02142%	0.02040%
Proportionate Share of the Net Pension Liability	$ 4,969,303	$ 6,813,564	$ 8,075,643	$ 6,981,282
Covered - Employee Payroll	$ 575,352	$ 678,461	$ 716,417	$ 682,292
Proportionate Share of the Net Pension Liability as Percentage of Covered-Employee Payroll	863.70%	1004.27%	1127.23%	1023.21%
Plan's Fiduciary Net Position	$ 13,302	$ (136,595)	$ (271,172)	$ (430,259)
Plan Fiduciary Net Position as Percentage of the Net Pension Liability	0.27%	-2.00%	-3.36%	-6.16%

Notes to Schedule:

Benefit Changes: In 2015, benefit terms were modified to base public safety employee pensions on a final three-year average salary instead of a final five-year average salary.

Changes Assumptions: In 2015, amounts reported as changes in assumptions resulted primarily from adjustments to expected retirement ages of general employees.

* Fiscal year 2015 was the first year of implementation, therefore onlly four years are shown.
The amounts presented have a measurement date of June 30, 2017
Data Reference Employees' Retirement System of the Government of the Commonwealth of Puerto Rico, Actuarial Valuation Report
** The Schedule of Proportionate Share for 2015 through 2018 are audited.

	2015	2016	2017	2018
Contractualy Required Contribution	$ 100,421	$ 130,115	$ 143,217	$ 145,339
Contributions in Relation to the Required Contributions	100,421	130,115	143,217	145,339
Contibution Deficiency (Excess)	$ -	$ -	$ -	$ -
Covered - Employee Payroll	$ 575,352	$ 678,461	$ 716,417	$ 682,292
Contributions as Percentage of Covered-Empolyee Payroll	17.45%	19.18%	19.99%	21.30%

Method and Assumptions Used in Calculation of the ER'S Annual Required Contributions

Unless otherwise noted above the following actuarial methods and assumpitions were used to determine contribution notes reported in the Pension Benefits Schedule of the Employee's Contributions.

Valuation date	July 1, 2017 that was rolled forward to June 30, 2018
Measurement Date	June 30, 2017
Actuarial Cost Method	Entry-Age Normal Cost Method
Asset Valuation Method	Not Applicable
Remaining Amortization Period	15 years
Actuarial Assumptions	
Inflation Rate	N/A
Projected Salary Increase	N/A
Salary Increase	3.00% per year. No compensation increases are assumed until July, 1, 2021 as a result of Act No. 3-2017, four-year extension of Act No. 66-2014 and the current general economy.
Mortality	Pre-retirement Mortality - For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. For members covered under Act No. 127, RB-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Sclae MP-2017 from the 2006 base year and projected forward using MP-2017 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational for members covered under Act No. 127. Pot-retirement Healthy Mortality - Rates which vary by gender are assumed for healthy retirees and beneficiaries based on study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 mortality Tables for Males and 95% of the rates from UP-1994 Mortality Table for Females, both projected from 1994 to Post-retirement Disabled Mortality - Rates which vary by gender are assumed for disabled retirees based on a study of the Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the UP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. The base rates are projected using Mortality Improvement Scale MP-2017 on a generational basis. As a Generational table, it reflects mortality improvements both before and after the measurement date.

1. The Office implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, during fiscal year 2015.

2. This information is intended to help users assess the Office's pension plan's status on a going-concern basis, assess progress made in accumulating assets to pay benefits when due, and make comparisons with other public employers.

3. The information presented relates solely to the Office and not Employee's Retirement System of the Government of the Government of Puerto Rico as a whole.

4. On August 23, 2017, was enacted the Act No. 106, known as the "Act to Guarantee Payment to Our Retirees and establish a New Plan for Defined Contributions for Public Employees". This Act determined and declared that the ERS, JRS and TRS are in a financial emergency. Also, by this Act is hereby created the Account for the Payment of Accumulated Pensions, a trust account, separated from the general assets and accounts of the Government, designated to pay the Accumulated Pensions by the ERS, JRS and TRS under the "*pay as you go*" scheme, as established in Chapter 2 of this Act. Once Retirement Systems exhaust their assets, the Accumulated Pension Payment Account, which will be largely nourished by the General Fund, as provided in this Act, will assume and guarantee the payment of the Accumulated Pensions as established in this Act. However, the Municipalities, the Legislative Branch, the Public Corporations, the Government and the Administration of the Courts will be obliged to pay the "Pay-Go" Charge as appropriate to each one to nurture the Account for the Payment of the Accumulated Pensions.

END OF NOTES

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CPA DIAZ-MARTINEZ, PSC
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

ENHANCING THE QUALITY OF ACCOUNTING, AUDITING AND ATTESTATION SERVICES

202 Gautier Benitez Ave.
Consolidated Mall C-31
PO Box 8369
Caguas, PR 00726-8369
Phones: (787) 746-0510 / 1185 / 1370
Fax: (787) 746-0525
cpadiazmartinez.com

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

To the Director of the
Office of Legislative Services
of the Legislative Assembly of the Government of Puerto Rico
San Juan, Puerto Rico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Office of Legislative Services of the Legislative Assembly of the Government of Puerto Rico** (**Office**), as of and for the fiscal year ended June 30, 2020, and the related notes to basic financial statements, which collectively comprise the **Office**'s basic financial statements, and have issued our report thereon dated May 27, 2021. Our report was qualified because we were unable to obtain sufficient appropriate audit evidence about the proportional share used to determine the deferred outflows/inflows of resources, net pension liability, pension expenses of the governmental activities and note of pensions plan the PRGERS has not issued, or made available information in order to properly adjust or disclose any deferred outflows/inflows of resources, or net OPEB obligation, if any, applicable to the **Office**.

Going Concern

Our report on the basic financial statements includes an emphasis-of-matter paragraph describing conditions, discussed in Note 14 to the basic financial statements, that raised substantial doubt about the Government of Puerto Rico's ability to continue as a going concern.

Entity Part of the Government of Puerto Rico

Our report on the basic financial statements includes an emphasis-of-matter paragraph drawing attention to Note 1 to the basic financial statements, which states that the basic financial statements include only the financial position and the changes in financial position of only that portion of the governmental activities of the financial reporting entity of the Government of Puerto Rico that is attributable to the transactions of the **Office**.

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the **Office**'s internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **Office**'s internal control. Accordingly, we do not express an opinion on the effectiveness of the **Office**'s internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the **Office**'s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weakness or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weakness. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **Office**'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the financial statements. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the **Office**'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
May 27, 2021

Stamp No. E438165 of the Puerto Rico Society of Certified
Public Accountants was affixed to the original report.