# COMMONWEALTH OF PUERTO RICO
# AUTONOMOUS MUNICIPALITY OF CAGUAS

## BASIC FINANCIAL STATEMENTS
## AND SUPPLEMENTARY INFORMATION

## FISCAL YEAR ENDED JUNE 30, 2020

[WITH THE ADDITIONAL REPORTS AND INFORMATION REQUIRED BY THE
GOVERNMENT AUDITING STANDARDS AND UNIFORM GUIDANCE]


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

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**PART I – Financial:**



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# PART I

# FINANCIAL

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CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

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# INDEPENDENT AUDITOR'S REPORT

**To the Honorable Mayor and**
**Members of the Municipal Legislature**
**Autonomous Municipality of Caguas**
**of the Commonwealth of Puerto Rico**

## Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of **Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico (Municipality)**, as of and for the fiscal year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise **Municipality**'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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 **Municipality**'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 **Municipality**'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 relations to pension and other postemployment benefits of the governmental activities and the related disclosures in the accompanying notes. As discussed in Notes 19 and 20, the Puerto Rico Government Employees Retirement System (PRERS) has not issued audited financial statements as of and for the fiscal years ended June 30, 2019 nor has provided to the **Municipality** 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 **Municipality** 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 Postemployment Benefits Plan"* paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of the **Municipality** 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 fund, and the aggregate remaining fund information of the **Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico**, as of June 30, 2020, and the respective changes in 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-Matter***

*Uncertainty about Ability to Continue as a Going Concern – Commonwealth of Puerto Rico*

As discussed in Note 26 to the basic financial statements on pages 126-128, the Commonwealth's recurring deficits, negative financial position, further deterioration of its economic condition, and inability to access the credit markets raises substantial doubt about the ability to continue as a going concern. The Commonwealth and its component units are currently under the supervision of a Federal Oversight Board, who have certified Fiscal Plan in order to remediate their situation. The **Municipality** is an instrumentality of the Commonwealth of Puerto Rico (Commonwealth). **Municipality**'s evaluation of the events and conditions, and management's plans to mitigate these matters are also described in that note. 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 6-22, Schedule of Revenues and Expenditures Budget and Actual – General Fund information on pages 162-163, and employees' retirement systems information, on pages 164-166 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 **Municipality**, in accordance with auditing standards generally accepted in the United States of America. We do not express an opinion or provide any assurance on the information.

*Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Municipality**'s basic financial statements. The accompanying Financial Data Schedules – Section 8 Housing Choice Vouchers Program, as required by U.S. Department of Housing and Urban Development, on pages 168 through 171, and the Schedule of Expenditures of Federal Awards, as required by *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Award,* on pages 173 through 177, is presented for purposes of additional analysis and is not required part of the basic financial statements.

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

In our opinion, the Financial Data Schedules – Section 8 Housing Choice Vouchers Program and the Schedule of Expenditures of Federal Awards are fairly stated, in all material respects, in relation to the financial statements as a whole.

**Other Reporting Required by *Governmental Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated May 27, 2021, on our consideration of the **Municipality**'s internal control over financial reporting on our test 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 considered **Municipality**'s internal control over financial reporting and compliance.

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

Caguas, Puerto Rico
May 27, 2021

Stamp No. E438161 of the Puerto Rico Society of Certified Public Accountants was affixed to the original report.

The information in this section is not covered by the Independent Auditor's Report, but is presented as required supplementary information for the benefit of the readers of the basic financial statements.

As management of the Autonomous Municipality of Caguas (hereafter the Municipality), we offer readers of the Municipality's financial statements this narrative overview and analysis of the financial activities of the Municipality for the fiscal year ended June 30, 2020. We encourage readers to read the information presented here in conjunction with the basic financial statements.

## *Financial Highlights*

- The net position of the Municipality shows that governmental assets and deferred outflows exceeded its liabilities and deferred inflows at the close of the fiscal year by $11,249,104.

- The government's total assets and deferred outflows of resources, in the Governmental-wide Statement of Net Position decreased by $15,035,121 and government's liabilities and deferred inflows of resources decreased by $20,504,560. These changes resulted in an increase in total net position of $5,469,439.

- As of the close of the current fiscal year, the Municipality's governmental funds reported combined ending fund balances of $16,852,141 after a total and combined net increase of $3,788,576.

- The Municipality's total general and special long-term debts net decreased by $12,777,700 during the current fiscal year.

- Prior period adjustment of $1,975,905 in the General Fund was the result of a repayment plan on pension expenditures with the Puerto Rico Retirement System Administration. The Beginning Net Position was restated to reflect a net adjustment to long term debt with the Retirement System Administration of $197,500. In addition, a prior period adjustment of $13,602,997 is the result of the Municipality's implementation of GASB Statement No. 75 related to recognition of Net OPEB Liability of $5,515,908, and a new adjustment in Net Pension Liability as reported in audited financial statements of the Employees Retirement System at June 30, 2017, by $8,087,089.

- Net Capital Assets from Governmental Activities as of June 30, 2020 was $375,722,916, presenting a net decrease of $8,666,676 with respect with prior year balance. This net decrease is the result of additions of $6,529,074, distributed in all categories; depreciation expense for the year of $15,049,716; and a loss on disposition of $146,034.

- Net decrease in Current Assets and Current Liabilities, was due to a change in the deadline to file and pay the Volume of Business Taxes for the next fiscal year. Due to COVID-19 pandemic, the due date to file and pay this tax, was changed instead of April 2020, was moved to July 2020. This presented a reduction in cash and unearned revenues in General Fund at June 30, 2020, of approximately $16.5 million.

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

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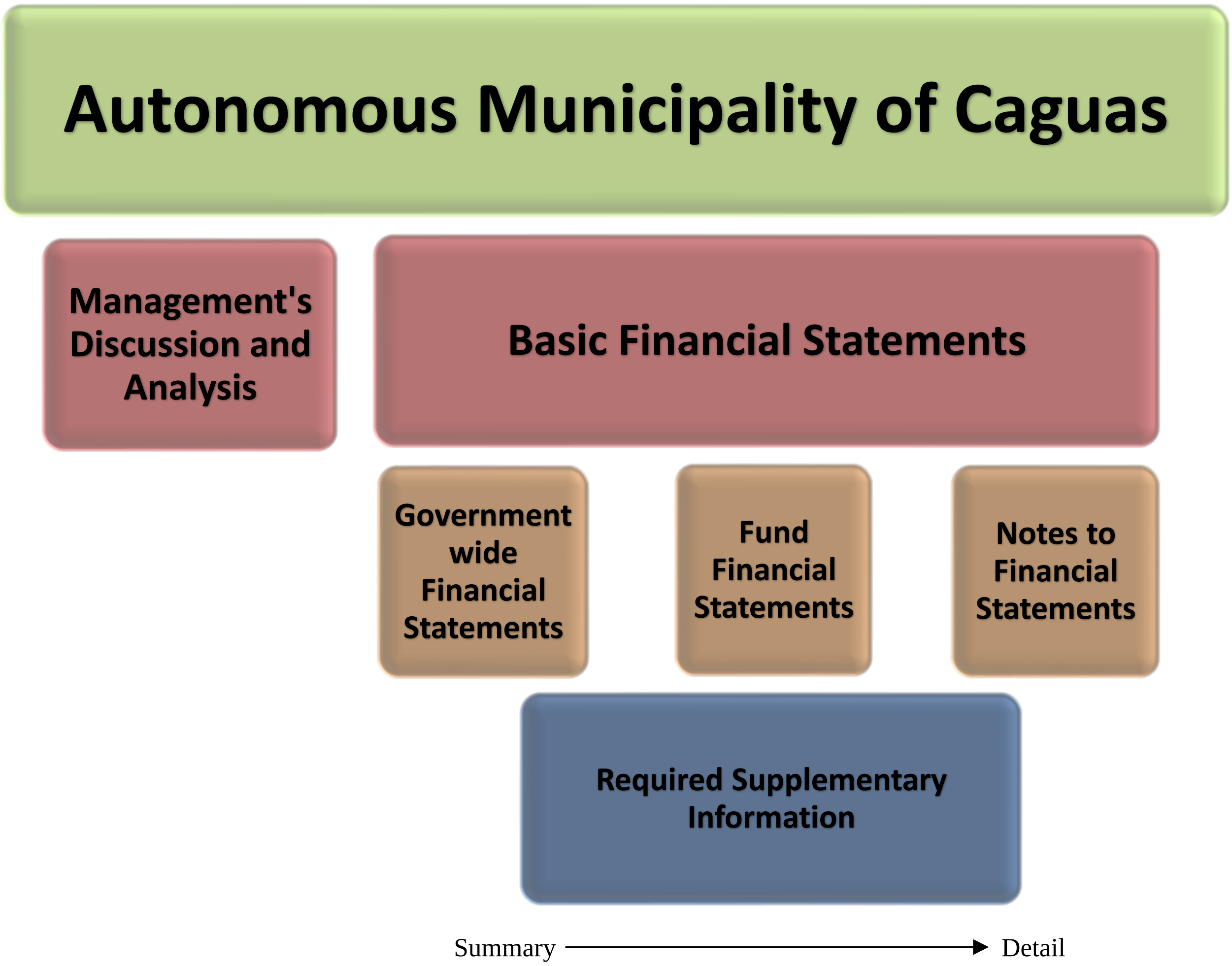
**Required Components of Annual Financial Report**
**Figure 1**




### Basic Financial Statements

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

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

### Government-wide Financial Statements (GWFS)

The GWFS are designed to provide the reader with a broad overview of the Municipality's finances. The GWFS provide short and long-term information about the Municipality's financial status as a whole.

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

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

The governmental activities include most of the Municipality's basic services such as public safety, culture and recreation and general administration. Property taxes, volume of business taxes and state and federal grant funds finance most of these activities.

The government-wide financial statements are included from pages 23 through 25 of this report.

***New Significant Accounting Standards Implemented***

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

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

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.

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**Governmental Fund Financial Statements (GFFS)**

The GFFS provide a more detailed look at the Municipality's most significant activities. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The Municipality, like all other governmental entities in the Commonwealth of Puerto Rico, uses fund accounting to ensure and reflect compliance (or non-compliance) with finance-related legal requirements, such as the General Statutes or the Municipality's budget ordinance.

Governmental funds are used to account for those functions reported as governmental activities in the GWFS. Most of the Municipality's basic services are accounted for in governmental funds. These funds focus on how assets can readily be converted into cash inflows and outflows, and what monies are left at year-end that will be available for spending in the next fiscal year.

Governmental funds are reported using an accounting method called modified accrual basis of accounting. This method is also known as current financial resources focus. Thus, the GFFS give the readers a detailed short-term view that helps them determine if there are more or less financial resources available to finance the Municipality's programs. The relationship between government activities (reported in the Statement of Net Position and the Statement of Activities) and governmental funds are described in reconciliations that are part of the GFFS.

The Municipality adopts an annual budget for its General Fund, as required by the General Statutes. The Municipality's annual budget is a legally adopted document that incorporates input from the citizens of the Municipality, the management of the Municipality, and the decisions of the Municipal Legislature about which services to provide and how to pay for them. It also authorizes the Municipality to obtain funds from identified sources to finance these current period activities. The budgetary schedule provided for the General Fund demonstrates how well the Municipality complied with the budget ordinance and whether the Municipality succeeded in providing the services as planned when the budget was adopted. The budgetary comparison schedule uses the budgetary basis of accounting and is presented using the same format, language, and classifications as the legal budget document. The statement shows four columns: 1) the original budget as adopted by the Municipal Legislature; 2) the final budget as amended by the Municipal Legislature; 3) the actual resources, charges to appropriations, and the final relationship between revenues and appropriations; and 4) the difference or variance between the final budget and the actual resources and charges.

The governmental funds financial statements are included from pages 26 through 29 of this report.

**Notes to Financial Statements** – The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes can be found on pages 30 through 160 of this report.

**Required Supplementary Information – Budgetary Information** – Provides additional information to better understand the financial position of the Municipality and contains the Schedule of Revenues and Expenditures Budget and Actual – General Fund, are presented immediately following the notes to the financial statements and can be found on pages 162-163 of this report.

**Required Supplementary Information – Pension Information** – The required supplementary information reported are related to the GASB Statement No. 68 and GASB Statement No. 71 for pension liability reporting, are presented on pages 164 through 166 of this report. After approval of Act 106-2017, the Fiduciary Fund of the PRGERS was liquidated and a new define contribution plan was created. PRGERS has not issued or made available the required financial information for fiscal year 2019 and 2020.

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## *FINANCIAL ANALYSIS OF THE MUNICIPALITY AS A WHOLE*

### Government-wide Financial Analysis

As noted earlier, net position may serve over time as one useful indicator of a government's financial condition. The total assets and deferred outflows of the Municipality exceeded its liabilities and deferred inflows by $11,249,104 as of June 30, 2020. The Municipality's net position increased by $5,469,439, as restated, for the fiscal year ended June 30, 2020.

One of the largest portions of the net position, $260,086,044, reflects the Municipality's investment in capital assets (e.g. land, buildings, infrastructure, and equipment); less any related debt still outstanding that was issued to acquire or contract those assets. The Municipality uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the Municipality's investment in its capital assets is reported net of the outstanding related debt, the resources needed to repay that debt must be provided by other sources, since the capital assets cannot be used to liquidate these liabilities.

An additional portion of the Municipality's net position $43,192,816 represents resources that are subject to external restrictions on how they may be used. Within this portion are $16,761,955 held by the Municipality in Escrow and Deposits Accounts for repayment of long-term debt, $10,609,917 restricted for Head Start program purposes, $6,522,561 for construction projects and $9,298,383 restricted, mainly, to provide housing services to the citizens, and services related to prevent and respond to COVID-19 pandemic.

An Unrestricted Net Position (Deficit) of ($292,029,756) was presented as of June 30, 2020. This balance was negatively affected primarily to by the recognition of Net Pension Liability, as required by GASB Statements No. 68 and 71, for the amount ($216,098,405), we were unable to present information under GASB Statement No. 73, because the Retirement System Administration did not provide data at June 30, 2019; also, Net Other Post Employment Benefit (OPEB) Liability, as required by GASB Statement No. 75, was presented in the amount of ($5,515,908). Other long-term debts, such as compensated absences ($14,164,187), the issuance of the Community Disaster Loan ($5,000,000), and Puerto Rico Retirement System Administration ($6,948,342), also affected the net position.

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## The Municipality's Net Position (as restated)
## Figure 2

| | Governmental Activities | | | |
|---|---|---|---|---|
| | 2020 | 2019 | Dollar Change | Percentage Change |
| Current and Other Assets | $ 62,275,766 | $ 69,028,367 | $ (6,752,601) | -8.14% |
| Capital Assets | 375,722,916 | 384,389,592 | (8,666,676) | -2.25% |
| Housing Units Held for Sale | 154,848 | 154,848 | - | 0.00% |
| Idle Units Held for Future Use | 1,252,349 | 1,252,349 | - | 0.00% |
| Restricted Cash | 1,131,721 | 1,110,353 | 21,368 | -100.00% |
| Loan Receivable, Net | 865,472 | 510,881 | 354,591 | 69.41% |
| Note Receivable, Net | 144,807 | 136,610 | 8,197 | 6.00% |
| Total Assets | 441,547,879 | 456,583,000 | (15,035,121) | -3.29% |
| Deferred Outflows of Resources | 37,650,339 | 37,650,339 | - | 0.00% |
| Current Liabilities | 43,370,317 | 54,500,635 | (11,130,318) | -20.42% |
| Other Liabilities | 397,498,390 | 406,872,632 | (9,374,242) | -2.30% |
| Total Liabilities | 440,868,707 | 461,373,267 | (20,504,560) | -4.44% |
| Deferred Inflows of Resources | 27,080,407 | 27,080,407 | - | 0.00% |
| Net Position: | | | | |
| Net Invested of Capital Assets | 260,086,044 | 257,976,410 | 2,109,634 | 0.82% |
| Restricted | 43,192,816 | 39,185,931 | 4,006,885 | 10.23% |
| Unrestricted (Deficit) | (292,029,756) | (291,382,676) | (647,080) | 0.22% |
| Total Net Position | $ 11,249,104 | $ 5,779,665 | $ 5,469,439 | 94.63% |

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Unaudited

**The Municipality's Changes in Net Position (as restated)**
**Figure 3**

| | Governmental Activities | | | |
|---|---|---|---|---|
| | 2020 | 2019 | Dollar Change | Percentage Change |
| Revenues: | | | | |
| Program Revenues: | | | | |
| Charges for Services | $ 2,655,387 | $ 2,924,506 | $ (269,119) | -9.20% |
| Operating Grants and Contributions | 40,697,508 | 35,615,794 | 5,081,714 | 14.27% |
| Capital Grants and Contributions | 175,702 | 165,798 | 9,904 | 5.97% |
| General Revenues: | | | | |
| Property Taxes | 43,469,734 | 48,400,174 | (4,930,440) | -10.19% |
| Volume of Business Taxes | 24,902,492 | 25,407,084 | (504,592) | -1.99% |
| Sales and Usage Taxes | 22,126,314 | 22,093,052 | 33,262 | 0.15% |
| Intergovernmental | 7,543,764 | 7,491,166 | 52,598 | 0.70% |
| Construction Excise Taxes | 3,514,419 | 4,968,686 | (1,454,267) | -29.27% |
| Interest and Investment Income | 322,441 | 451,369 | (128,928) | -28.56% |
| Donated Capital Assets | - | 120,000 | (120,000) | -100.00% |
| Gain on sale of Capital Assets | 312,000 | 1,353,662 | (1,041,662) | -76.95% |
| Other | 2,730,683 | 3,072,873 | (342,190) | -11.14% |
| Insurance Recovery | - | 797,274 | (797,274) | -100.00% |
| Total Revenues | 148,450,444 | 152,861,438 | (4,410,994) | -2.89% |
| Expenses: | | | | |
| General Government | 42,599,702 | 38,271,730 | 4,327,972 | 11.31% |
| Public Safety | 7,383,598 | 7,461,983 | (78,385) | -1.05% |
| Public Works | 19,341,570 | 18,125,103 | 1,216,467 | 6.71% |
| Cultural and Recreation | 7,905,543 | 8,264,803 | (359,260) | -4.35% |
| Health and Welfare | 3,526,195 | 3,049,634 | 476,561 | 15.63% |
| Economic and Social Development | 7,017,179 | 7,161,351 | (144,172) | -2.01% |
| Housing | 10,763,257 | 9,669,283 | 1,093,974 | 11.31% |
| Sanitation and Environmental | 13,259,928 | 14,150,461 | (890,533) | -6.29% |
| Education | 21,555,553 | 20,755,406 | 800,147 | 3.86% |
| Interest | 9,628,480 | 11,087,368 | (1,458,888) | -13.16% |
| Total Expenses | 142,981,005 | 137,997,122 | 4,983,883 | 3.61% |
| Net Change in Net Position | 5,469,439 | 14,864,316 | (9,394,877) | -63.20% |
| Net Position, Beginning of Year, as Restated | 5,779,665 | (9,084,651) | 14,864,316 | -163.62% |
| Net Position, Ending | $ 11,249,104 | $ 5,779,665 | $ 5,469,439 | 94.63% |

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**Governmental Activities** – Governmental activities increased the Municipality's net position by $5,469,439. Key elements of this change in net position are the following:

**Revenues:**

Total overall revenues decreased by 2.89% over prior year. The following categories had the mayor changes from prior year:

- Operating Grants and Contributions increased 14.27% over prior year – due to an increase in state and federal funding related to COVID-19 pandemic safety relief measures.

- Charges for Services decreased 9.20% over prior year – due to the lockdown implemented in Puerto Rico by the Government from March 15, 2020, through the end of fiscal year, the lockdown included must of government and private business operations in Puerto Rico in order to avoid the spreading of the COVID-19 infection among the people in Puerto Rico.

- Construction Excise Taxes decreased by 29.27% - this reduction was mainly due to the lockdown discussed above, which affected the construction industry.

- Property Taxes decreased by 10.19% - the decrease was due collections made from the Municipal Revenues Collection Center, recognized in the Debt Service Fund.

- Other decreases in Gains on Sale and Insurance Recovery are expected, as they are non-recurrent source of revenue.

**Expenses:**

Total overall expenses had a net increase of 1.8% over prior year. The following categories had the major changes from prior year:

- General Government increased 11.31% – due to increase in long-term expenditures related to Puerto Rico Health Insurance Administration and Retirement System Administration. In addition, expenditures from all funds were increased in relation to COVID-19 pandemic, for which additional funding were provided by state and federal funds.

- Health and Welfare increased 15.63% – the increase was mainly related to funds incurred to prevent the spreading of COVID-19 infection.

- Housing increased 11.31% – the increase was mainly related to additional funding expended in the HOME Program.

- Culture and Recreation decreased -4.35% – the decrease is a result of activities that were postponed by the Municipality due to the COVID-19.

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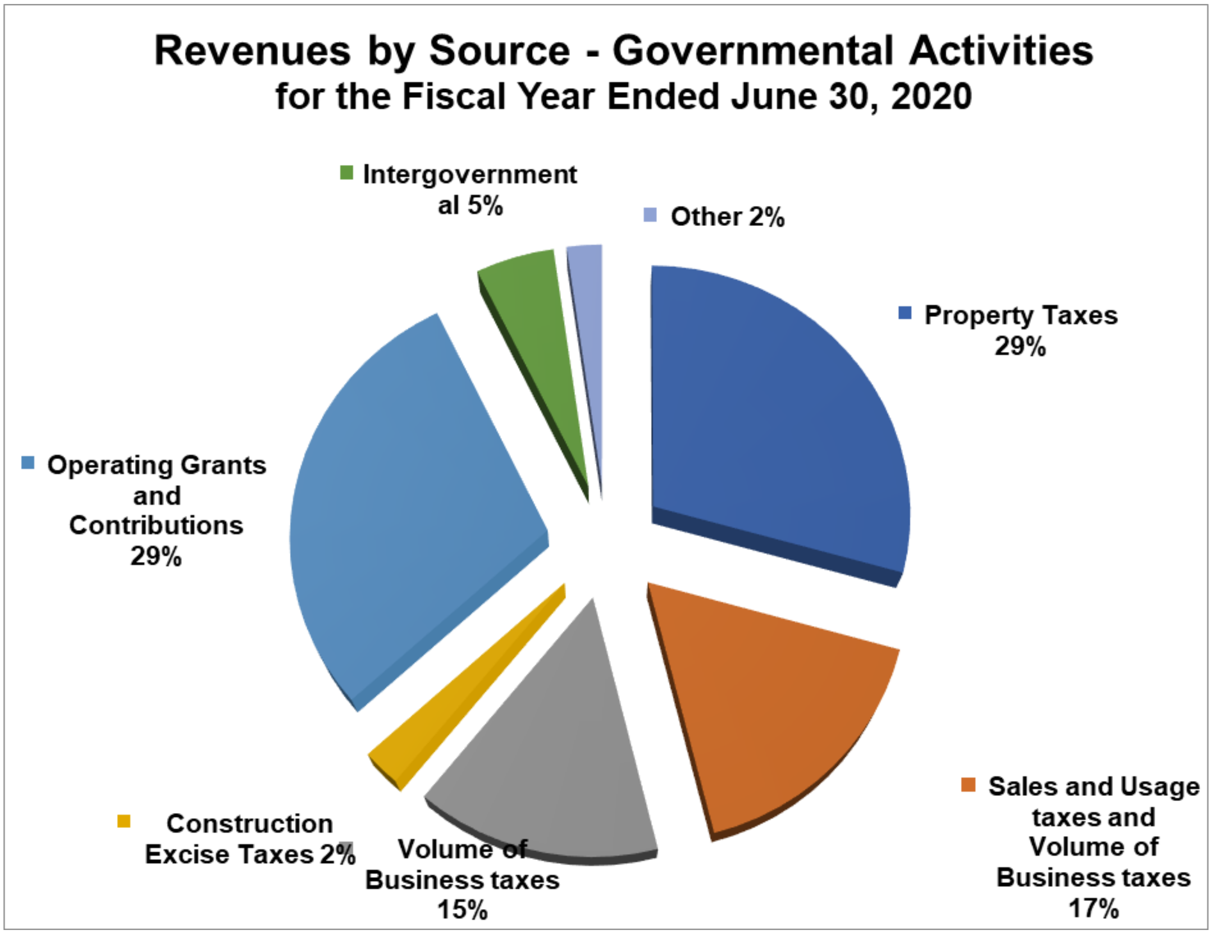
**Figure 4**




## Financial Analysis of the Municipality's Funds

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

**Governmental Funds** – The focus of The Municipality's governmental funds is to provide information on near-term inflows, outflows, and balances of usable resources. Such information is useful in assessing the Municipality's financing requirements. Specifically, unassigned fund balance can be a useful measure of a government's net resources available for spending at the end of the fiscal year.

On June 30, 2020, the governmental funds of the Municipality reported a combined fund balance of $16,852,141. This amount represents an increase of $3,788,576 or 29% over last year, as restated. The restatement to the beginning fund balance is due to a reduction of presentation in the governmental funds of a reclassification of accounts payable, for repayment plan to governmental agency of $1,975,000. This long-term debt will not be repaid with current financial resources therefore this debt is presented only in the Government Wide Financial Statements.

The net increase in fund balances during the fiscal year was caused by a reduction of revenues from property taxes, sales and usage taxes and other financial resources; overall revenues decreased by 2.1%. Expenditures presented a decrease of 13% in comparison with prior year. This reduction is related to the set-off transaction recorded last year as a result of the RSA agreement of AAFAF.

continue

Following is a summary of the most relevant funds' changes when compared to prior year:

General Fund – The general fund revenues decreased by $6 million. Construction and Excise Revenues decreased by $1.5 million, which are related to the impact of the lockdown implemented in Puerto Rio. In addition, a decrease in Federal Grants of $3.9 million in FEMA funds. A decrease in Volume of Business Taxes of $505 thousands was because in prior year, the Municipality collected additional funds from a claim with a taxpayer.

The expenditures decreased by approximately $5.1 million, in comparison from prior year. The categories with the major decreases were Public Safety and Sanitation and Environmental. Public Safety decreased by $1.7 million because the salary of the Municipal Police was charged to the Coronavirus Relief Fund (CRF), as an eligible expenditure. The Sanitation and Environmental function decreased by $2.3 million, because the Municipality received $1.8 million from the Commonwealth to deal with the operational expenditures amid the crisis created by COVID-19. Expenditures related to waste disposal was charged to these funds, which were presented in Other Non-Major Funds.

The net change in fund balance from General Fund with respect to prior years, is $8.5 more, this change is due to the adjustments and transfers of cash to the Debt Service Fund, recognized in prior year, in order to account for the special payment of cash from GDB accounted for in the General Fund.

Capital Projects Fund – Expenditures from this fund, increased by approximately $2.8 million. This increase is related to projects financed from a transfer from Debt Service Fund for excess of equity, which were used in minor repairs and maintenances, and reported in the function of Public Works. In addition, during the fiscal year, the Municipality began with repairs of infrastructure and buildings, from FEMA funds. Revenues presented, remain basically the same from prior year.

Debt Service Fund –The fund's expenditures decreased by $26 million, caused by a decrease in the debt service principal payments presented last fiscal year, because of the special payment to reduce debt, required by law. Revenues, on the other hand, presented a decrease of approximately $4.6 million, which was expected due to the impact of COVID-19 in property taxes payments and sales and usage taxes.

Health and Human Services Fund – Revenues and expenditures from the HHS fund increased by approximately $800 thousand, from federal grants appropriations. The fund had net change of ($684,226), mainly for funds expended and not received from the Child Care and Development Fund and the Title III Cluster for Aging, during the revenue recognition period. An increase in expenditures of $1.2 million, approximately, is due to Disaster Recovery Funds from Head Start Program, which were assigned to major improvements, and construction of a building for the Head Start Program.

Other Governmental Funds – Revenues increased by $7 million, mainly due to an increase in federal and state assignments for COVID-19 pandemic relief. The expenditures increased by $4.6 million on COVID-19 safety measures and housing programs. The housing expenditures increased due to a housing grant (HOME) to provide home acquisition for the citizens. Expenditures related to COVID-19, includes payroll, solid waste and COVID-19 safety services.

**General Fund Budgetary Highlights**: During the fiscal year 2020 the Municipality's budget was changed, according to the latest results and ordinances and resolutions approved by the Mayor and the Municipal Legislature. Generally, budget amendments fall into one of three categories: 1) amendments made to adjust the estimates that are used to prepare the original budget ordinance once exact information is available; 2) amendments made to recognize new funding amounts from external sources, such as Federal and State grants and from appropriation from prior year fund balance; and 3) increases in appropriations as a result of cash surplus from prior period to supplement capital projects funding and general government activities.

continue

The following were most significant budgetary transactions:

- The original General Fund appropriation for fiscal year 2020 was $82,552,482 which is less than the prior year appropriations by $154,957.

- Actual budgetary transactions generated an excess of resources over appropriations of $2,838,886 due to the following:

    - Actual revenues were less than budgeted amounts by $2,322,314. This was the result of a combination of a decrease in Construction Excise Taxes that were not attained as budgeted, and a positive variance in Volume of Business Taxes. In addition, Property Taxes were adjusted by the Fiscal Oversight Board through the MRCC.

    - Actual appropriations resulted in an economy of $5,161,200. All functions presented economies.

**Figure 5**

| | Original | Increases | Final |
|---|---|---|---|
| **Resources:** | | | |
| Property Taxes | $ 28,362,729 | $ 1,195,481 | $ 29,558,210 |
| Volume of Business Taxes | 22,675,000 | 703,544 | 23,378,544 |
| Sales and Usage Taxes | 17,000,000 | 2,358,199 | 19,358,199 |
| Construction Excise Taxes | 7,415,000 | - | 7,415,000 |
| Intergovernmental Revenues | 4,682,108 | - | 4,682,108 |
| Interest | 110,000 | - | 110,000 |
| Rent and Other Resources | 1,707,645 | - | 1,707,645 |
| Fines and Penalties | 600,000 | - | 600,000 |
| Amounts available for appropriation | 82,552,482 | 4,257,224 | 86,809,706 |
| **Expenditures charged to appropriations:** | | | |
| General Government | $ 39,276,563 | $ 2,217,468 | $ 41,494,031 |
| Public Safety | 7,481,526 | (625,962) | 6,855,564 |
| Public Works | 8,710,339 | 3,643,048 | 12,353,387 |
| Culture and Recreation | 4,119,970 | (89,026) | 4,030,944 |
| Health and Welfare | 1,885,373 | (39,144) | 1,846,229 |
| Economic and Social Development | 3,499,127 | (188,608) | 3,310,519 |
| Housing | 840,023 | (20,626) | 819,397 |
| Sanitation and Environmental | 15,047,189 | (617,754) | 14,429,435 |
| Education | 1,692,372 | (22,173) | 1,670,199 |
| Total charges to appropriations | 82,552,482 | 4,257,224 | 86,809,706 |
| **Excess of resources over appropriations** | $ - | - | $ - |

continue



Unaudited

## Capital Asset and Debt Administration

**Capital Assets** – The Municipality's capital assets for its governmental activities as of June 30, 2020, total $375,722,916 (net of accumulated depreciation). These assets include buildings, roads and bridges, land, machinery and equipment, park and recreations facilities, and vehicles. New construction in progress began during the year, most of them are related to improvements to facilities affected by Hurricane María, for a total investment during the year of $3,260,867. Depreciation expense for the fiscal year was $15,049,716, and additions to equipment and other capital assets were $6,529,074. Retirements of capital assets during year were in equipment and vehicles ($2,378,524), presenting a loss on disposition of $146,034. In addition, sales of land were made during the year, which reported a gain of $312,000, the value of these lands were nominal, $1.

**The Municipality's Capital Assets**
**(Net of Depreciation)**
**Figure 6**

| | Total | | | |
|---|---|---|---|---|
| | **2020** | **2019** | **Dollar Change** | **Percentage Change** |
| Capital Assets Not Being Depreciated | | | | |
| Land and Improvements | $ 93,410,025 | $ 93,262,982 | $ 147,043 | 0.16% |
| Construction in Progress | 4,411,751 | 1,923,246 | 2,488,505 | 129.39% |
| Works of Art and Historical Treasures | 2,660,429 | 2,645,189 | 15,240 | 0.58% |
| Total Assets Not Being Depreciated | 100,482,205 | 97,831,417 | 2,650,788 | 2.71% |
| Capital Assets Net of Depreciation | | | | |
| Facilities and Improvements | 49,978,212 | 51,823,266 | (1,845,054) | -3.56% |
| Buildings and Improvements | 56,525,002 | 57,876,093 | (1,351,091) | -2.33% |
| Infrastructure | 161,612,322 | 168,674,008 | (7,061,686) | -4.19% |
| Equipment and Vehicles | 7,125,175 | 8,184,808 | (1,059,633) | -12.95% |
| Total Assets Net of Depreciation | 275,240,711 | 286,558,175 | (11,317,464) | -3.95% |
| Total Capital Assets Net of Depreciation | $ 375,722,916 | $ 384,389,592 | $ (8,666,676) | -2.25% |

Additional information on the Municipality's capital assets can be found on Note 11 of the Basic Financial Statements on pages 76-77.

Major additions to constructions in progress (disbursements of more than $100,000) as of June 30, 2020 are as follows:

| Project | Amount |
|---|---|
| Idamaris Gardens, Court | $ 521,276 |
| Borinquen Recreative Installations | 407,779 |
| "Centro Multigeneracional" Head Start | 592,721 |
| Improvements to "Plaza del Mercado" | 554,802 |
| Facilities "Bairoa La 25" | 384,386 |
| Improvements to "Parque Los Campeones" | 205,515 |
| "Complejo Recreo Deportivo del Este" | 129,398 |
| | $ 2,795,877 |

continue

## Deferred Outflows / Inflows of Resources

### *Deferred Outflows of Resources*

Deferred outflows of resources are new to the Municipality'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 a Municipality 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, most the deferred outflows of resources reported are comprised of current year contributions to the retirement system. We were unable to present the applicable amounts under GASB Statement 68, 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 Municipality as of the date of the financial statements. When all the recognition criteria are met, the deferred inflow of resources will become revenue or an increase to net position.

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

More detailed information about the Municipality's deferred outflows of resources and deferred inflows of resources is presented in Notes 13 and 18 to the financial statements on pages 78 and 85 respectively of this report.

**Long-Term Debts** – As of June 30, 2020, the Municipality had total bonded debt outstanding of Special and General Obligations of $165,871,092 all of which is debt backed by the full faith and credit of the Municipality.

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continue

**The Municipality's Outstanding Debts**
**Long-Term Debts**
**Figure 7**

| | Governmental Activities 2020 | Governmental Activities 2019 | Dollar Change | Percentage Change |
|---|---|---|---|---|
| General Obligations Bonds | $ 118,848,832 | $ 126,514,532 | $ (7,665,700) | -6.06% |
| Special Obligations Bonds | 47,022,260 | 51,534,260 | (4,512,000) | -8.76% |
| Federal Loans | 5,000,000 | 5,600,000 | (600,000) | -10.71% |
| Net OPEB Liability | 5,515,908 | 5,515,908 | - | n/a |
| Net Pension Liability | 216,098,495 | 216,098,495 | - | 0.00% |
| PR Health Insurance Administration (ASES) | 1,541,509 | - | 1,541,509 | n/a |
| Law No. 142-MRCC | 1,191,409 | 1,253,087 | (61,678) | -4.92% |
| PR Retirement System Administration | 6,948,342 | 5,914,550 | 1,033,792 | 67.95% |
| Claims and Judgments | 129,868 | 171,387 | (41,519) | -24.23% |
| MRCC-Property Taxes Liquidation | - | 149,233 | (149,233) | -100.00% |
| Christmas Bonus | 831,646 | 830,363 | 1,283 | 0.15% |
| Retainage Liability | 364,842 | 141,979 | 222,863 | 156.97% |
| Compensated Absences | 14,164,187 | 13,008,141 | 1,156,046 | 8.89% |
| Total | $ 417,657,298 | $ 426,731,935 | $ (9,074,637) | -0.41% |

The Municipality's debt related to General, Special and Federal obligations decreased by $12,777,700 (25%) during the fiscal year 2020.

Additional information on the Municipality's long-term debts can be found on Note 16 of the Basic Financial Statements on pages 79 through 83.

Also, the Municipality has a sales tax redemption fund, composed of .2% of the .5% of the municipal sales tax rate portion of 1.5%, to support the debt service fund capacity. This fund, in addition to other variables, is used to calculate the Municipality's borrowing capacity, along with the property tax redemption fund, within a specific timeframe. On February 1, 2014 was enacted Act Nos. 18 and 19 that change the composition of the sales and usage taxes (see Note 3).

## Summary of Local Economy

The Municipality of Caguas was founded in 1775. Caguas has the fifth largest population of Puerto Rico with boundaries that encompass an area of approximately 59.07 square miles, and according to the 2010 Puerto Rico Community Survey the population of Caguas was 142,893. It was estimated by the US Census that the population of Puerto Rico had an overall decrease of over 19,000 citizens during the last 15 months ended in July 2012. Notwithstanding, it was also estimated that from the largest municipalities, Caguas had the lowest decrease of 1.7%. The Municipality's jurisdiction is bounded on the North by the Municipalities of San Juan and Trujillo Alto, on the South by the Municipalities of Cayey and San Lorenzo, on the East, by the Municipalities of Gurabo and San Lorenzo, and on the West by the Municipalities of Aguas Buenas and Cidra.

continue

One (1) of the seven (7) largest companies in PR dedicated to contracting electrical and mechanical construction are located in Caguas with 250 full-time employees and $ 18.7M in sales (2019); Aireko Energy Solution, LLC. Two (2) of the seven (7) largest companies in PR dedicated to supplying construction materials are located in Caguas with combined sales of $ 78.5M; Servimetal LLC and Steel and Pipes. One (1) of the ten (10) largest companies in PR dedicated to the Management of Shopping Centers is located in Caguas with a leased footage of 2.2 million square feet (2019); Kimco Realty Corp. One (1) of the nine (9) largest companies in PR dedicated to systems integration and IT consulting with thirty (30) full-time consultants; and $ 5M in sales (2019); Cortelco System, PR Inc. One (1) of the ten (10) largest companies in PR dedicated to telecommunications is located in Caguas; Data Access Communications, Inc. One (1) of the thirty (30) fastest growing companies in PR is located in Caguas with 97 full-time employees and sales of $ 21.3M; Mech-Tech College LLC. Two (2) of the ten (10) largest female-owned local capital companies in Puerto Rico are located in Caguas.

The Municipality's economy has an industry composition somewhat like the rest of the island's largest Municipalities. In the 1960's textile manufacturing and agriculture made up the largest amount of the local economy, but by the mid-seventies the manufacturing share of employment had declined to a lower percentage. Caguas is among the first five cities with the largest population in Puerto Rico, it has a per capita income $15,244 higher than Puerto Rico's $ 12,914 by 18%, 53.6% of the population is made up of women and 46.4% men, according to the most recent Socio-Economic Study of the Municipality of Caguas (2019).

**Major Industries and Services (including Government)**

**Government Services:** The governmental service is the largest source of employment in the Municipality, accounting for the largest quantity of employment. The Municipal government sector remains stable in relation to the past year. Government sector includes a diversity of employment areas such as education, electric power service, water supply, police, public works, culture and recreation, health, legal service, and others.

**Health Services:** As a major regional medical center, the medical services industry is one of the largest employers in the area. It includes the privately-owned hospitals, HIMA-San Pablo and Hospital Menonita, formerly San Juan Bautista. These facilities provide primary, secondary and tertiary health services to the residents of Caguas and adjacent small towns, and are responsible for establishing and developing strategies and programs designed to promote health, prevent diseases and early detection and diagnosis of health problems. They promote adequate health treatment and rehabilitation services as well.

Caguas is included in the Commonwealth's Health Reform program. The Commonwealth's Health Reform program consists of comprehensive health insurance coverage for qualifying low-income residents of Puerto Rico through a managed care system. Under the Health Reform program, the Government of Puerto Rico selects, through a bidding system, one private health insurance company in each of several designated regions of Puerto Rico and pays such insurance company the insurance premiums for each eligible beneficiary within such region. In accordance with Law No. 253-2018, the annual contribution to the municipalities was waived during the period from July 1, 2018 to September 30, 2019. Accordingly, the Municipality had an expenditure of $1,541,509. Caguas participates in this program not only as a health provider, through its facilities, but also as an Independent Provider Association (IPA) sharing with insurers the health insurance risk.

**Trade (Retail and Wholesale):** The trade sector is the strongest growing sector in the area. Many major national chains such as Wal-Mart, Costco, and Home Depot have expanded into the area, helping maintain relatively stable levels of consumer spending.

continue

**Going Concern – Commonwealth of Puerto Rico**

As explained on Note 26 to the basic financial statements on pages 126-128 of this report, the Commonwealth of Puerto Rico (Commonwealth) currently faces a severe fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base, has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services, like subsidies to municipalities, which are instrumentalities of the Commonwealth.

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

**Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA)**

Also, attention was directed to Note 27 to the basic financial statements on pages 129-159 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.

As part of the Fiscal Plan presented by the Governor of Puerto Rico to attend the fiscal crisis, a proposal contemplates a reduction of $370 million of subsidies to the municipalities of Puerto Rico. Also, a new increase in rates of property tax is contemplated to substitute the reduction in subsidies. 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 May 9, 2019 (Sixth Fiscal Plan), there must be a reduction of 20% in each successive year, holding appropriations constant at roughly 45-50% of current levels starting in FY 2022 before ultimately phasing out all subsidies in FY 2024.

**Economic and Budget Highlights for the Fiscal Year Ending June 30, 2020**

**Governmental Activities:** The general fund budget for fiscal year 2020-2021 will be $79.8 million, representing a decrease of $2.7 million when compared with fiscal year ended June 30, 2020. These $79.8 are composed of $73 million from taxes, $ 5 from governmental grants and $ 1.8 million from charges from services.

Special revenues funds budget will be composed, mainly, from federal grants, $42.1 million. For the repayment of long-term debt, budget will be expected to be $17.4 million. These resources will come from property and sales and usage taxes revenues.

continue

On March 15, 2020, the Government of Puerto Rico lockdown must of government and private business operations in Puerto Rico in order to avoid the spreading of the COVID-19 infection among the people in Puerto Rico. This situation will have an economic impact over the Municipality for fiscal year 2019-2020 and fiscal year 2020-2021, as exceptions and dates for filing taxes were waived for more than 3 months. The economic damages to the Municipality finances could not been estimated at this time.

**Requests for Information**

This report is designed to provide an overview of the Municipality's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to: Autonomous Municipality of Caguas, Office of the Mayor, P.O. Box 907, Caguas, Puerto Rico, 00726-0907, or http://www.caguas.gov.pr.

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| | | GOVERNMENTAL ACTIVITIES |
|---|---|---|
| **ASSETS:** | | |
| Current Assets: | | |
| Cash and Investments | $ | 16,963,965 |
| Cash with Fiscal Agent | | 22,240,213 |
| Receivables (Net): | | |
| Sales and Usage Taxes | | 3,008,755 |
| Volume of Business Taxes | | 241,976 |
| Due from Government Units | | 1,445,339 |
| Federal Grants | | 17,729,266 |
| Construction Excise Taxes | | 286,870 |
| Other | | 359,382 |
| Restricted Cash | | 1,131,721 |
| Total Current Assets | | 63,407,487 |
| Non-Current Assets: | | |
| Loans Receivables, Net | | 865,472 |
| Notes Receivable, Net | | 144,807 |
| Land, Improvement and Construction in Progress | | 100,482,205 |
| Other Capital Assets [Net of Accumulated Depreciation] | | 275,240,711 |
| Housing Units Held for Sale | | 154,848 |
| Idle Units Held for Future Use | | 1,252,349 |
| Total Non-Current Assets | | 378,140,392 |
| **TOTAL ASSETS** | | **441,547,879** |
| **DEFERRED OUTFLOWS OF RESOURCES:** | | |
| Contributions to Employees Retirement System | | 37,650,339 |
| **TOTAL OUTFLOWS OF RESOURCES** | | **37,650,339** |
| **LIABILITIES:** | | |
| Current Liabilities: | | |
| Accounts Payable | | 15,271,962 |
| Accrued Expense | | 831,646 |
| Accrued Interest | | 3,541,149 |
| Bonds Payable | | 12,894,700 |
| Advance Deposits | | 1,179,343 |
| Unearned Revenues | | 944,151 |
| Accrued Compensated Absences | | 3,982,964 |
| Legal Claims | | 18,718 |
| Due to Governmental Entities | | 4,705,684 |
| Total Current Liabilities | | 43,370,317 |

continue

| | GOVERNMENTAL ACTIVITIES |
|---|---|
| Non-Current Liabilities: | |
| Bonds Payable | 152,976,392 |
| Accrued Compensated Absences | 10,181,223 |
| Legal Claims | 111,150 |
| Due to Governmental Entities | 7,250,380 |
| Retainage Payable | 364,842 |
| Community Disaster Loan Program | 5,000,000 |
| Net OPEB Liability | 5,515,908 |
| Net Pension Liability | 216,098,495 |
| Total Non-Current Liabilities | 397,498,390 |
| **TOTAL LIABILITIES** | **440,868,707** |
| **DEFERRED INFLOWS OF RESOURCES:** | |
| Unamortized Investment in Employees Retirement System | 27,080,407 |
| **TOTAL INFLOWS OF RESOURCES** | **27,080,407** |
| **NET POSITION:** | |
| Net Investment in Capital Assets | 260,086,044 |
| Restricted for: | |
| Capital Projects | 6,522,561 |
| Debt Service | 16,761,955 |
| Head Start Program | 10,609,917 |
| Other Purposes | 9,298,383 |
| Unrestricted (Deficit) | (292,029,756) |
| **TOTAL NET POSITION** | **$ 11,249,104** |

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

| Functions/Programs | Expenses | Program Revenues: Charges For Services | Program Revenues: Operating Grants and Contributions | Program Revenues: Capital Grants and Contributions | Net (Expense) Revenues |
|---|---|---|---|---|---|
| **Governmental Activities:** | | | | | |
| General Government | $ 42,599,702 | $ - | $ 72,627 | $ - | $ (42,527,075) |
| Public Safety | 7,383,598 | 1,836,380 | 3,880,068 | 137,735 | (1,529,415) |
| Public Works | 19,341,570 | - | - | 37,967 | (19,303,603) |
| Culture and Recreation | 7,905,543 | 25,200 | - | - | (7,880,343) |
| Health and Welfare | 3,526,195 | - | 2,703,358 | - | (822,837) |
| Economic and Social Development | 7,017,179 | 666,159 | 4,478,206 | - | (1,872,814) |
| Housing | 10,763,257 | - | 9,304,042 | - | (1,459,215) |
| Sanitation and Environmental | 13,259,928 | 127,648 | 2,204,873 | - | (10,927,407) |
| Education | 21,555,553 | - | 18,054,334 | - | (3,501,219) |
| Unallocated Interest | 9,628,480 | - | - | - | (9,628,480) |
| **Total Governmental Activities** | **$ 142,981,005** | **$ 2,655,387** | **$ 40,697,508** | **$ 175,702** | **(99,452,408)** |

| | |
|---|---|
| **General Revenues:** | |
| Taxes: | |
| Property Taxes, levied for General Purposes | 27,206,514 |
| Property Taxes, levied for Debt Service | 16,263,220 |
| Volume of Business Taxes | 24,902,492 |
| Sales and Usage Taxes | 22,126,314 |
| Construction Excise Taxes | 3,514,419 |
| Intergovernmental | 7,543,764 |
| Interest | 322,441 |
| Gain on Sale of Capital Asset | 312,000 |
| Other General Revenues | 2,730,683 |
| **Total General Revenues** | 104,921,847 |
| **CHANGES IN NET POSITION** | **5,469,439** |
| Net Position – Beginning of Year, As Restated | 5,779,665 |
| **NET POSITION – ENDING OF YEAR** | **$ 11,249,104** |

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

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| | GENERAL FUND | CAPITAL PROJECTS FUND | DEBT SERVICE FUND | HEALTH AND HUMAN SERVICES FUND | OTHER NON MAJOR FUNDS | TOTAL GOVERNMENTAL FUNDS |
|---|---|---|---|---|---|---|
| **ASSETS:** | | | | | | |
| Cash and Cash Equivalents | $ 3,225,912 | $ 8,626,756 | $ - | $ 161,891 | $ 4,949,406 | $ 16,963,965 |
| Cash with Fiscal Agent | - | 1,823,540 | 20,303,104 | - | 113,569 | 22,240,213 |
| Receivables: | | | | | | |
| Sales and Usage Taxes | 3,008,755 | - | - | - | - | 3,008,755 |
| Volume of Business Taxes | 241,976 | - | - | - | - | 241,976 |
| Due from Governmental Units | 1,445,339 | - | - | - | - | 1,445,339 |
| Federal Grants | - | 2,967,061 | - | 12,158,990 | 2,603,215 | 17,729,266 |
| Construction Excise Taxes | 286,870 | - | - | - | - | 286,870 |
| Due from Other Funds | 6,344,299 | - | - | - | - | 6,344,299 |
| Others | 344,507 | - | - | - | 14,875 | 359,382 |
| Loans Receivable | - | - | - | - | 865,472 | 865,472 |
| Restricted Cash | - | 1,131,719 | - | - | 2 | 1,131,721 |
| **Total Assets** | **$ 14,897,658** | **$ 14,549,076** | **$ 20,303,104** | **$ 12,320,881** | **$ 8,546,539** | **$ 70,617,258** |
| **LIABILITIES:** | | | | | | |
| Account Payable | $ 11,627,487 | $ 1,647,213 | $ - | $ 860,773 | $ 1,136,489 | $ 15,271,962 |
| Bond Payable | - | - | 8,152,700 | - | - | 8,152,700 |
| Interest on Bonds Payable | - | - | 3,541,149 | - | - | 3,541,149 |
| Due to Governmental Entities | 2,274,804 | - | - | - | - | 2,274,804 |
| Due to Other Funds | - | 3,682,171 | - | 2,341,164 | 320,964 | 6,344,299 |
| Advance Deposits | 1,178,343 | - | - | - | 1,000 | 1,179,343 |
| Unearned Revenues | 762,251 | - | - | - | 181,900 | 944,151 |
| **Total Liabilities** | **15,842,885** | **5,329,384** | **11,693,849** | **3,201,937** | **1,640,353** | **37,708,408** |
| **DEFERRED INFLOWS OF RESOURCES:** | | | | | | |
| Unavailable Revenues: | | | | | | |
| Commonwealth of Puerto Rico | 1,278,385 | - | - | - | - | 1,278,385 |
| Federal Grants | - | 2,085,357 | - | 10,595,112 | 2,097,855 | 14,778,324 |
| **Total Deferred Inflows of Resources** | **1,278,385** | **2,085,357** | **-** | **10,595,112** | **2,097,855** | **16,056,709** |
| **FUND BALANCES:** | | | | | | |
| Restricted | 847,539 | 3,712,739 | 8,609,255 | 14,805 | 5,974,248 | 19,158,586 |
| Committed | - | - | - | - | 34,487 | 34,487 |
| Assigned | - | 3,421,596 | - | - | - | 3,421,596 |
| Unassigned (Deficit) | (3,071,151) | - | - | (1,490,973) | (1,200,404) | (5,762,528) |
| **Total Fund Balances** | **(2,223,612)** | **7,134,335** | **8,609,255** | **(1,476,168)** | **4,808,331** | **16,852,141** |
| **Total Liabilities, Deferred Inflows of Resources and Fund Balances** | **$ 14,897,658** | **$ 14,549,076** | **$ 20,303,104** | **$ 12,320,881** | **$ 8,546,539** | **$ 70,617,258** |

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

| | | |
|---|---|---|
| **Total Fund Balances – Government Funds (Page 26)** | | **$ 16,852,141** |
| Amount reported for Governmental Activities in the Statement of Net Position (Page 24) 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: | | |
| Non Depreciable Capital Assets | $ 100,482,205 | |
| Depreciable Capital Assets | 695,336,765 | |
| Accumulated Depreciation | (420,096,054) | |
| Total Capital Assets | | 375,722,916 |
| Other assets held for sell of idle property held for future use are not financial resources and therefore, are not reported in the funds. In the current period, these amounts are: | | |
| Housing Units Held for Sale | 154,848 | |
| Idle Units Held for Future Use | 1,252,349 | |
| Total Other Assets | | 1,407,197 |
| Deferred Outflows of Resources in Governmental Activities are not recorded in the funds in the current period. | | 37,650,339 |
| Notes Receivables from sale of capital assets in Governmental Activities are not recorded in the funds in the current period. | | 144,807 |
| Some of the **Municipality**'s revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are unavailable in the funds: | | |
| Federal Grants | 14,778,324 | |
| MRCC- Property Taxes | 1,278,385 | |
| Total Unavailable Revenues | | 16,056,709 |
| Deferred Inflows of Resources in Governmental Activities corresponded to future period and therefore are not reported in the funds. | | (27,080,407) |
| Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of: | | |
| General and Special Obligation Bonds | (157,718,392) | |
| Net Pension Liability | (216,098,495) | |
| Net OPEB Liabilty | (5,515,908) | |
| Compensated Absences | (14,164,187) | |
| Community Disaster Loan | (5,000,000) | |
| PR Health Insurance Administration (ASES) | (1,541,509) | |
| Puerto Rico Retirement System Administration | (6,948,342) | |
| Claims and Judgments | (129,868) | |
| Christmas Bonus | (831,646) | |
| Retainage Payable | (364,842) | |
| Law No. 142 | (1,191,409) | |
| Total Long-Term Liabilities | | (409,504,598) |
| **Total Net Position of Governmental Activities (Page 24)** | | **$ 11,249,104** |

The accompanying *Notes to 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 | CAPITAL PROJECTS FUND | DEBT SERVICE FUND | HEALTH AND HUMAN SERVICES FUND | OTHER NON MAJOR FUNDS | TOTAL GOVERNMENTAL FUNDS |
|---|---|---|---|---|---|---|
| **REVENUES:** | | | | | | |
| Property Taxes | $ 27,285,613 | $ - | $ 16,263,220 | $ - | $ - | $ 43,548,833 |
| Volume of Business Taxes | 24,902,492 | - | - | - | - | 24,902,492 |
| Sales and Usage Taxes | 18,817,821 | - | 3,308,493 | - | - | 22,126,314 |
| Construction Excise Taxes | 3,514,419 | - | - | - | - | 3,514,419 |
| Federal Grants | 1,698,408 | 2,085,374 | - | 17,952,544 | 15,428,451 | 37,164,777 |
| Fines and Penalties | 1,836,380 | - | - | - | - | 1,836,380 |
| Intergovernmental | 8,264,920 | 10,000 | - | - | 2,194,646 | 10,469,566 |
| Interest | 250,955 | 22,324 | - | 331 | 40,634 | 314,244 |
| Rent and Other Services | 765,852 | 2,155 | - | - | 12,783 | 780,790 |
| Solid Waste Disposal | 125,493 | - | - | - | - | 125,493 |
| Other General Revenues | 1,574,415 | - | - | - | 972,819 | 2,547,234 |
| **Total Revenues** | **89,036,768** | **2,119,853** | **19,571,713** | **17,952,875** | **18,649,333** | **147,330,542** |
| **EXPENDITURES:** | | | | | | |
| Current: | | | | | | |
| General Government | 36,915,945 | 894,902 | - | 17,995 | 1,340,913 | 39,169,755 |
| Public Safety | 5,053,756 | 423,106 | - | - | 1,538,412 | 7,015,274 |
| Public Works | 8,433,575 | 3,270,473 | - | - | 43,572 | 11,747,620 |
| Culture and Recreation | 3,744,712 | 35,826 | - | - | 10,500 | 3,791,038 |
| Health and Welfare | 2,242,103 | 163,035 | - | 364,790 | 505,454 | 3,275,382 |
| Education | 1,985,901 | 74,795 | - | 16,642,310 | 1,343,609 | 20,046,615 |
| Sanitation and Environmental | 11,295,367 | 77,970 | - | - | 1,622,572 | 12,995,909 |
| Economic and Social Development | 5,287,244 | 317,133 | - | 129,072 | 329,750 | 6,063,199 |
| Housing | 708,668 | 79,725 | - | - | 9,782,927 | 10,571,320 |
| Capital Outlay | 3,043,334 | 1,061,608 | - | 1,498,234 | 641,820 | 6,244,996 |
| Debt Service: | | | | | | |
| Principal | 61,678 | 600,000 | 12,642,700 | - | - | 13,304,378 |
| Interest and Other Charges | 76,595 | 9,900 | 9,541,985 | - | - | 9,628,480 |
| **Total Expenditures** | **78,848,878** | **7,008,473** | **22,184,685** | **18,652,401** | **17,159,529** | **143,853,966** |
| **EXCESS OF REVENUES OVER (UNDER) EXPENDITURES** | **10,187,890** | **(4,888,620)** | **(2,612,972)** | **(699,526)** | **1,489,804** | **3,476,576** |
| **OTHER FINANCING SOURCES (USES):** | | | | | | |
| Transfers – In | 883,857 | 1,974,558 | 5,921,431 | 15,300 | 364,673 | 9,159,819 |
| Transfers – Out | (6,763,625) | - | (2,378,677) | - | (17,517) | (9,159,819) |
| **Total Other Financing Sources (Uses)** | **(5,879,768)** | **1,974,558** | **3,542,754** | **15,300** | **347,156** | **-** |
| **SPECIAL ITEMS:** | | | | | | |
| Sales of Other Assets | 51,000 | 261,000 | - | - | - | 312,000 |
| **Total Special Items** | **51,000** | **261,000** | **-** | **-** | **-** | **312,000** |
| **Net Change in Fund Balances** | **4,359,122** | **(2,653,062)** | **929,782** | **(684,226)** | **1,836,960** | **3,788,576** |
| Fund Balances – Beginning, As Restated | (6,582,734) | 9,787,397 | 7,679,473 | (791,942) | 2,971,371 | 13,063,565 |
| **FUND BALANCES – ENDING** | **$ (2,223,612)** | **$ 7,134,335** | **$ 8,609,255** | **$ (1,476,168)** | **$ 4,808,331** | **$ 16,852,141** |

The accompanying *Notes to 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 28)** | | **$ 3,788,576** |
| Amount reported for Governmental Activities in the Statement of Activities (Page 25) are different because: | | |
| Governmental funds report capital outlays as expenditures. However, in the Statement of 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: | | |
| Capital Outlays | $ 6,244,996 | |
| Depreciation Expense | (15,049,716) | |
| Excess of Capital Outlays over Depreciation Expense | | (8,804,720) |
| Revenues in the Statement of Activities that do not provide current financial resources are not reported as revenues in the funds: | | |
| Federal Grants | 878,804 | |
| MRCC - Property Taxes Liquidation | (79,099) | |
| Total Revenues | | 799,705 |
| Governmental funds only report the proceeds received in the disposal of assets. In the Statement of Activities, a gain or loss is reported for each disposal. Thus, the change in net position differs from the change in fund balance by the cost of the disposed asset. | | (146,034) |
| Notes receivables classified as long term, because the due date is not current, are recorded in the Statement of Net Position. In the current period the change in note receivables was | | 8,197 |
| Repayment of long-term principal is expenditure in the governmental funds, but the repayment reduced Noncurrent Liabilities in the Statement of Net Position. In the current period repayments were | | 13,304,378 |
| 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: | | |
| Decrease in Legal Claims | 41,519 | |
| Increase in Christmas Bonus | (1,283) | |
| Increase in PR Health Insurance Administration (ASES) | (1,541,509) | |
| Increase in Puerto Rico Retirement System Administration | (1,033,792) | |
| Decrease in MRCC - Property Taxes Liquidation | 149,233 | |
| Decrease in Retainage Liability | 61,215 | |
| Increase in Compensated Absences | (1,156,046) | |
| Total Additional Expenses | | (3,480,663) |
| **Change in Net Position of Governmental Activities (Page 25)** | | **$ 5,469,439** |

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

## 1. FINANCIAL REPORTING ENTITY

The accompanying financial statements present information on the financial activities of the Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico (Municipality) over which the Mayor and the Municipal Legislature, have direct or indirect governing and fiscal control. The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP).

### A. Organization

The Municipality was founded in 1775, and operates as a governmental unit of the Commonwealth of Puerto Rico under Law No. 81 of August 30, 1991, known as the "Autonomous Municipalities Laws of the Commonwealth of Puerto Rico". The governmental system of the Municipality is composed of the executive and legislative bodies. It is governed by a Mayor and a 16-member Municipal Legislature elected for a four-year term.

The Municipality provides services such as: health, public works, sanitation, aids and services to low-income and elderly citizens, public safety, housing and urban development, culture and recreation, planning, zoning and other general and administrative services. As a government entity, the Municipality is exempt from both federal and state taxes.

### B. Reporting Entity

A reporting entity is comprised of (1) the primary government, (2) component unit organizations for which the primary government is financial accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete, and they are financially accountable to the primary government. The primary government consists of all funds, departments, boards and agencies that are not legally separate from the Municipality and for which the Municipality is financial accountable.

The accompanying basic financial statements include all departments and organizations units whose funds are under the custody and control of the Municipality. In evaluating the Municipality as a reporting entity, management has addressed all the potential component units. GASB Accounting Standards Codification Section 2600, *Reporting Entity and Component Unit Presentation and Disclosure,* require the inclusion of organizations that raise and hold funds for the direct benefit of the primary government.

GASB Accounting Standards Codification Section 2100, *Defining the Financial Reporting Entity*, describes the criteria for determining which organizations, functions, and activities should be considered part of the Municipality for financial reporting purposes. The primary criteria include appointing a voting majority of an organization's governing body, and the Municipality's ability to impose its will on that organization or the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the Municipality. Second criteria used in evaluating potential component units is if the nature and significance of the relationship between the organization and a primary government are such that to exclude the organization from the financial reporting entity would render the financial statements misleading or incomplete.

A legally separate, tax-exempt organization should be discretely presented as a component unit if all of the following criteria are met: (a) the economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents; (b) the primary government, or its component units, is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization, and; (c) the economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to the primary government.

continue

## 1. FINANCIAL REPORTING ENTITY – continuation

GASB Statement 61, *The Financial Reporting Entity: Omnibus an Amendment of GASB Statements No. 14 and No. 34,* provides additional criteria for classifying entities as component units to better assess the accountability of elected officials by ensuring that the financial reporting entity includes only organizations for which the elected officials are financially accountable or that are determined by the government to be misleading to exclude.

There are two methods of presentation of the component unit in the financial statements: blending – the financial data of the component unit's balances and transactions in a manner similar to the presentation of the Municipality's balances and transactions; and discrete – presentation of the component unit's financial data in column separate from the Municipality's balances and transactions. The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Based on these criteria, there are no other organizations which should be included in these basic financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These financial statements present the respective financial position of the Governmental Activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2020, and the respective changes in financial position, and the cash flows, where applicable, thereof for the fiscal year then ended. The Governmental Accounting Standards Boards (GASB) is the accepted standard-setting body for established governmental accounting and financial reporting principles. The more significant of the Municipality's accounting policies are described below.

### A. Financial Statement Presentation

The accompanying basic financial statements of the Municipality present the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the Municipality, as of June 30, 2020, the respective changes in financial position of the governmental activities, each major fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2020, in conformity with accounting principles generally accepted in the United Stated of America as applicable to local governmental units (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB). The basic financial statements include both government-wide (based on the Municipality 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 type.

The financial information of the Municipality 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 Municipality'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 Municipality. For the most part, the effect of interfund activity has been removed from these financial statements. Exceptions to this general rule are payments in lieu of taxes where the amounts are reasonably equivalent in value to the interfund services provided and other charges between the government's Puerto Rico Electric Power Authority function of the government. Elimination of this charges would distort the direct cost and program revenue reported for the various functions concerned. Governmental Activities, which normally are supported by taxes and intergovernmental revenues.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The focus of GWFS is on the operational accountability of the Municipality as a single economic unit and not on compliance with budgets, regulatory requirements or on the use of available or currently expendable financial resources (referred to as fiscal accountability). Operational accountability is the Municipality's responsibility to report to the extent to which it has met its operating objectives efficiently and effectively, using all resources available for that purpose. It focuses on the Municipality's principal operating objective, which is to provide services to its citizens.

The *Statement of Net Position* is designed to be similar to bottom line results for the Municipality'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 Municipality'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 Municipality'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 (Expenses) and Changes in Fund Balance*] provide information about the Municipality's funds. Separate statements for each fund category-governmental are presented. The emphasis on fund financial statements is on major governmental, each displayed in a separate column. All remaining governmental are aggregated and reported as nonmajor funds. 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 Municipality 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 percent of the aggregated total for both governmental funds and enterprise funds of any one of the items for which it met the ten percent criterion. In addition, a fund may be reported as major if it is believed to be of particular importance to financial statement users.

The Municipality reports the following major governmental funds:

<u>General Fund</u> – This fund is the general operating fund of the Municipality. The general fund is used to account for and report all financial resources not accounted for and reported in another fund.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

Capital Projects Fund – Capital projects fund is used to account for financial resources to be used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds, if any. It also includes the Community Development Block Grants (CDBG) which is awarded to develop viable urban communities by providing decent housing and suitable living environment for persons of low and moderate income.

Debt Service Fund – The debt service fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs.

Health and Human Services Fund – This fund started as a major fund during this year. It is used to account for the revenue and expenditures of the Head Start Program and the Elderly Center of the Municipality as well as other related welfare services.

The Municipality periodically undertakes a comprehensive evaluation of its fund structure to ensure that it complies with all aspects that are of importance to users of general purpose external financial reports. Consequently, all superfluous funds and some operational funds currently used by the Municipality in the day-to-day accounting procedures have not been reported as individual governmental funds in the accompanying fund financial statements. Accordingly, the accompanying fund financial statements include only the minimum number of funds consistent with legal and operating requirements and, consequently, certain types of similar operational funds have been combined into single funds in the accompanying fund financial statements.

The financial statements of the governmental funds are the following:

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

*Statement of Revenues, Expenditures and Changes in Fund Balances* – Report's information about the inflows, outflows and balances of current financial resources of each major governmental fund for the fiscal year ended June 30, 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 Municipality 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. Balances between the funds included in Governmental Activities (i.e., the governmental funds) are eliminated so that only the net amount is included as internal balances in the Governmental Activities column.

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 Municipality reports its financial position (*Balance Sheet*) and results of operations [*Statement of Revenues, Expenditures, and Changes in Fund Balance*] 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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### Notes to Financial Statements

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

### Required Supplementary Information – Budgetary 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 – General Fund – Non-GAAP Budgetary Basis*, 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

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the Municipality's fiscal year beginning July 1, 2014, revises existing standards for measuring and reporting pension liabilities for pension plans provided by the Municipality to its employees, and required supplementary information that include the Schedule of Proportionate Share of the Net Pension Liability and Schedule of Municipality's Contributions to the Employees' Retirement Systems. 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, or net OPEB obligation, if any, applicable to the Municipality. Therefore, the amounts presented were those from audited schedules applicable up to June 30, 2018

### *Required Supplementary Information – Other Postemployment Benefits (OPEB)*

The contribution requirement of ERS Medical Insurance Plan Contribution (MIPC) is established by Act No. 95-1963. 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.

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 Municipality.

## B. 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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### 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 Municipality gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants, entitlements and donations. On an accrual basis, revenue from property taxes is recognized in the fiscal year for which the taxes are levied. Revenue from grants, entitlements and donations is recognized in the fiscal year in which all eligibility requirements have been met, other than time requirements. These resources relate to a future period (when the advance is first permitted to be used in accordance with the government-mandated nonexchange transaction or a voluntary nonexchange transaction) and, therefore, should be classified as a deferred inflow of resources until such time as the resources are first permitted to be used. Receipts on any type of revenue sources collected in advance for use in the following fiscal year are recorded as unearned revenues.

### 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 Municipality considers revenues to be available if they are collected within sixty (60) days after the end of the current fiscal period. Revenues that the Municipality 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.

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

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 bonds payable are recorded when they matured (when payment is due), except for principal and interest of bonds due on July 1, 2020, which are recorded as governmental fund liabilities of June 30, 2020 which is the date when resources were available in the debt service fund. Proceeds of general long-term debts 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*.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

### C. Stewardship, Compliance, and Accountability

#### Budgetary Information

The Municipality's annually adopts the Budget Resolution for all operating funds of the Municipality except for certain restricted accounts (Unassigned Fund Balance up to the maximum of cash available). Budgetary control is legally maintained at the fund level. The budget is prepared using the modified accrual basis of accounting with encumbrance included as budgetary basis expenditures. Unexpended appropriations at the end of the fiscal year generally lapse. However, they may be re-appropriated for expenditures in the following fiscal year.

The Municipality's Budget Resolution provides transfer authority (1) to the Mayor and the Management and Budget Director, within and between departments and funds, as long as the total budget of the Municipality (net of interfund transfers) is not increased; (2) to the Management and Budget Director to implement grant budgets as the grant applications are accepted by the Municipality; and (3) to the Management and Budget Director to amend (re-appropriate) each new year's budget, to the extent of outstanding encumbrances, and/or unexpended project/grant appropriations at year end. Municipality's Legislature action is required for (1) use of the budgeted Legislature contingency, and (2) the approval of a supplemental appropriation(s). During the year, several supplemental appropriations were necessary.

For budgetary purposes, encumbrance accounting is utilized to the extent necessary to assure effective budgetary control and accountability and to facilitate effective cash planning and control. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For GAAP reporting purposes, encumbrances outstanding at year-end are reported as assigned fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year. In addition, under the budgetary basis of accounting, revenues are recorded when cash is received.

The unencumbered balance of any appropriation at the end of the year will lapse at the end of such fiscal year. Other appropriations, mainly capital project appropriations, are continuing accounts for which the Municipal Legislature has authorized that an unspent balance from the prior year be carried forward and made available for current spending.

The Municipality follows these procedures, in accordance with law, in order to establish the budgetary data reflected in the *Schedule of Revenues and Expenditures Budget and Actual – General Fund*:

#### Original Budget

1. Prior of May 15 of each fiscal year, the Mayor submits to the Municipal Legislature a proposed budget for the fiscal year commencing the following July 1 in addition of a budget message.

2. The budget document is available for public inspection prior to its approval by the Municipal Legislature.

3. The Office of the Commissioner of Municipal Affairs examines the budget to verify if it complied with the law's standards and sends it to the Mayor for any comments or recommendation before the limited date establishes by the Law.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

4. Prior to June 13, the annual budget is legally enacted through passage of the annual appropriation ordinance to be effective on July 1.

Act No. 154 of December 19, 2013 amended Sections 7.002 and 7.003 of Act. 81 of 1991, as amended, known as the "Autonomous Municipalities Act of the Commonwealth of Puerto Rico of 1991" for the purpose of establishing the budget of each municipality shall not exceed income certified in the external audit report or "single audit" for the previous fiscal year in revenue from Volume of Business Taxes, Sales and Usage Taxes (SUT), and Licenses and Permits; and that in these cases, the estimated revenue mechanism cannot be used to support the operating budget of a municipality. Also, the Act establish that municipalities reflecting a surplus in the current budget should be used to repay debt, and that by exception may establish an Emergency Fund, and enter up to thirty percent (30%) of the surplus to that fund. In addition, the municipalities that have not accumulated deficits may be used the surplus to increase the Emergency Fund.

Since the budgetary basis differs from accounting principles generally accepted in the United States of America (GAAP), actual amounts for the General Fund in the accompanying *Schedule of Revenues and Expenditures Budget and Actual – General Fund*, is presented on the budgetary basis to enhance comparability.

**Final Budget**

The final budgetary data presented in the *Schedule of Revenues and Expenditures Budget and Actual – General Fund* reflects the following changes to the original budget:

1. Certain annual appropriations are budgeted on a project basis. If such projects are not completed at the end of the fiscal year, unexpended appropriations, including encumbered funds, and unexpended grant appropriations, are carried forward to the following year. In certain circumstances, other regular annual appropriations may be carried forward after appropriate approval. Annually appropriated funds, not authorized to be carried forward, lapse at the end of the fiscal year. Appropriations carried forward from the prior year are included in the final budgetary data.

2. Appropriations may be adjusted during the year with the approval of the Mayor and the Municipal Legislature, e.g. supplemental appropriations. Additionally, the Mayor is authorized to make certain transfer of surplus within the departments. Such adjustments are reflected in the final budgetary data.

   The Annual Appropriation Ordinance adopts the budget at the character level of expenditure within departments. As described above, the Mayor is authorized to make certain transfers of appropriations within departments. Accordingly, the legal level of budgetary control by the Municipal Legislature is the department Level.

The principal differences between the budgetary and GAAP bases are the following:

1. Encumbrances are recorded as expenditures under the budgetary basis and as restricted, committed and assigned fund balances under GAAP.

2. Interfund transactions of the General Fund are not included in the budgetary basis.

3. Certain accrued liabilities and other debts are not included in the budgetary basis.

4. Certain revenues susceptible to accrual, i.e., both measurable and available, are not included in the budgetary data.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

The Special Revenue Fund has not been included in the budgetary comparison because balances are not budgeted. Also, the budget prepared for the Federal Financial Awards Programs included in the Capital Projects and Special Revenue Funds is based on a program period which is not necessarily the same fiscal year. Accordingly, it's not practical to present an annual comparison of budget for such programs.

### D. Assets, Deferred Outflows of Resources, Liabilities, Deferred Inflows of Resources, and Net Position / Fund Balance

#### 1) Cash, Cash Equivalents, Cash with Fiscal Agent, and Investment

The Municipality's cash are composed of demand deposits and cash equivalents in commercial banks, demand deposits in the Fiscal Agency and Financial Advisory Authority (FAFAA) (after GDB closed), and cash equivalents in commercial banks. The Municipality has adopted the *Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico*, issued by the GDB as promulgated by Act No. 113 of August 3, 1995. The Finance Director of the Municipality, follows the guidelines, is responsible for investing the available resources in certificates of deposit and other short-term investments. Investments are made from the available combined funds of the Municipality and, accordingly, it is not practical to disclose certificates of deposit and other short-term investments individually by fund in the combined financial statements.

Interest earned on certificates of deposit and other short-term investments are recognized as revenue in the General Fund in accordance with the amount invested. Cash in the Special Revenue and Capital Project Funds are restricted; accordingly, resources available were not used for pool investments. Cash Equivalents are investments with an original maturity of 90 days or less.

Cash with Fiscal Agent in the Debt Service Fund represents special additional property tax collections retained and deposited in the Popular Bank of Puerto Rico and restricted for the payment of the Municipality's debt service, as established by law. Cash with Fiscal Agent in the Capital Projects and other governmental funds consists of undisbursed proceeds of certain bonds issued with the private banking, and deposited in different private banks in Puerto Rico, for the acquisition and construction of major capital improvements, and other purposes.

Restricted Cash in governmental funds consists of undisbursed line of credit which are maintained in a cash custodian account by the FAFAA (after GDB closed) with Popular Bank of Puerto Rico. The final use of this cash account should be determined by FAFAA.

#### 2) 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."

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

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

Receivables consist of all revenues earned but not collected at 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 contributions from sales and usage taxes corresponding to June revenues collected during July and August 2020. Intergovernmental receivables in the other governmental funds represent amounts owed to the Municipality for reimbursement of expenditures incurred pursuant to federally funded grant and contributions and state appropriations, and the amount in the debt service fund represents the distribution of property tax collected which is restricted for the debt service.

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

**3) Inventories**

The Municipality used the purchase method to account for the purchases of office and printing supplies, gasoline, oil and other expendable supplies held for consumption. This method records items as expenditures, in the appropriate fund, when they are acquired and, accordingly, the inventory is not recorded in the basic financial statements.

**4) Capital Assets**

Capital assets acquired or constructed, whether owned by governmental activities are recorded and depreciated in the government-wide financial statements. No long-term capital assets or depreciation are shown in the governmental funds' financial statements.

Capital assets include public domain infrastructure (e.g., roads, bridges, sidewalks and other assets that are immovable and of value only to the Municipality). Capital assets with an individual cost of $40,000 or more are recorded at cost or estimated historical cost if purchased or constructed. Capital assets under this amount are capitalized if the estimated life of assets is extended by more than 25%, the cost results in an increase in the capacity of the asset, the efficiency of the assets is increased by more than 10%, significantly changes the character of the assets or in the case of streets and roads-if the work done impacts the "base" structure. Donated capital assets are recorded at the acquisition value at the date of donation. Equipment and other with a cost of $100 or more are recorded at cost or estimated historical cost.

The cost of normal maintenance and repairs that do not add to the value of the capital asset or extend capital assets lives are not capitalized. Major improvements are capitalized and depreciated over the remaining useful lives of the related capital assets. Finally, major outlays for capital assets and improvements are capitalized as the projects are constructed.

When capital assets that are to be used in governmental activities are purchased or constructed, the resources expended for those assets are reported as expenditures in the governmental funds within the capital outlays and included as additions in the roll-forward activity of the capital assets in the GWFS. However, in the *Statement of Activities*, the cost of those assets is allocated over the estimated useful lives and reported as a depreciation expense. As a result, fund balance decreases by the capital outlays balance – the amount of financial resources expended, whereas net position decreases by the amount of depreciation expense charged for the year.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Capital assets are depreciated using the straight-line method over the following estimated useful lives:

| CAPITAL ASSETS | YEARS |
|---|---|
| Facilities and Improvements | 10-40 |
| Buildings and Improvements | 10-50 |
| Infrastructure | 10-50 |
| Equipment and Vehicles | 5-20 |
| Work of Art (Inexhaustible) | N/A |

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 function.

The accounting policy for Works of Art is that they are capitalized at their historical cost or fair value at date of donation whether they are held as individual items or in a collection. Capitalized collections or individual items that is exhaustible, such as exhibits whose useful lives are diminished by display or educational or research applications, are depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible. On June 30, 2020, all Work of Art are considered inexhaustible.

As per GASB No. 42, impaired capital assets that will no longer be used by the Municipality, 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 Municipality 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. For impairment losses recoverable through disaster assistance programs sponsored by higher levels of government (such as the Federal Emergency Management Agency), the loss is reported separately from the grant awarded for recovery purposes. Any impairment adjustment to the carrying value of a capital asset would be treated as a proportionate reduction of both the reported value of the asset and its accumulated depreciation, based on the notion that the impairment represents the effective retirement of a portion of the asset.

The Municipality is prevented legally from entering obligations extending beyond one fiscal year, and most lease agreements entered by the Municipality contain fiscal funding clauses or cancellation clauses that make the continuation of the agreements subject to future appropriations. The Municipality's lease agreements do not include contingent rental payments no escalation clauses. Accordingly, lease payments are recorded in the GWFS as expense when incurred. In the accompanying GFFS, the lease payments are recorded as expenditures in the governmental fund.

### 5) Housing Units Held for Sale

Capital assets that have been identified to be for sale are presented as part of the noncurrent assets.

### 6) Idle Units Held for Future Use

Capital assets that have been temporarily idled and held for future use are presented as part of the noncurrent assets.

### 7) Unearned Revenues

In the GWFS, unearned revenues arise only when the Municipality receives resources before it has a legal claim to them. In the GFFS, it arises when the following situations occur: potential revenue does not meet both the measurable and available criteria for revenue recognition in the current period.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### 8) 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 Municipality recognizes deferred outflows and inflows of resources.

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 Municipality reports the following as deferred outflows of resources and deferred inflows of resources.

- The deferred outflows of resources or deferred inflows of resources resulting from the implementation of GASB No. 68, instead of GASB No. 73. Note 18 presents additional information about the composition of these items.

- Various types of revenues earned but not available within 60 days of fiscal year end.

Notes 13 and 18 provides details on deferred outflows of resources and deferred inflows of resources.

The Municipality has items, which arise only 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 report *unavailable revenues* from two sources: Liquidation from Municipal Revenue Collection Center (MRCC), and Federal Grants. This amount is deferred and recognized as an inflow of resources in the period that the amount become available.

### 9) Long-Term Obligations, Bonds Issuance Costs, and Premium or Discount

The liabilities reported in the GWFS include the general and special obligation bonds, long-term notes, other noncurrent liabilities (e.g., vacation, sick leave, claims and judgments, noncurrent liabilities to other governmental entities and third parties, and landfill post closure care costs). Bond premiums and discounts, if any, are deferred and amortized over the life of the bonds using the effective interest method. Bond's payable is reported net of the applicable bond premium or discount, if any. As per GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, Bond Issuance Costs incurred are reported as expense in the fiscal year incurred.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

In the GFFS, governmental fund types recognize bond premiums and discounts, if any, as other financing sources and uses, respectively, and bond issuance costs as debt service expenditures. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures. Expenditures for principal and interest payments for governmental fund general and special obligations bonds are recognized in the Debt Service Fund when due.

### 10) Compensated Absences

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

In accordance with the above criteria and requirements in conformance with GASB Accounting Standards Codification Section C60, *Compensated Absences,* the Municipality has accrued a liability for compensated absences, which has been earned but not taken by Municipality's employees, including its share of social security and Medicare payments made on behalf of the employees in the accrual for vacation and sick leave pay using salary rates effective at June 30, 2020. All vacation pay is accrued when incurred in the GWFS. For the GWFS, the current portion is the amount estimated to be used in the following year. For the GFFS, all of the compensated absences are considered long-term and therefore, are not a fund liability and represents a reconciling item between the fund level and government-wide presentations. Also, GFFS record expenditures when employees are paid for leave or the balance due in accrued upon the employee's separation from employment.

### 11) Reduction of Working Day

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

### 12) 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 Noncurrent Liabilities includes an amount estimated as a contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### 13) Fair Value

The Municipality 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 Municipality's principal market, or the Municipality'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 Municipality 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 Municipality 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 Municipality uses the fair value of that asset to measure the fair value of the liability. The Municipality's financial instruments consist of cash and cash equivalents, accounts and loans receivable, other assets, accounts payable and accrued liabilities, bonds and notes payable and other long-term obligations.

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

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

***Level 2 -*** Inputs to the valuation methodology include:

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

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

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Based on the criteria set forth above, the Municipality 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 Municipality'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 bonds payable, notes payable and other Jong-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 Municipality 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 Municipality. 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.

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 Municipality'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 Municipality's financial instruments were not considered significant by the Municipality on June 30, 2020.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### 14) Accounting for Pension Costs

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

In addition, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, effective for the Municipality's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the Municipality 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 No. 68, is required to be implemented simultaneously with the provisions of GASB No. 68.

The Municipality implemented both GASB Statements No. 68 and No. 71 for the fiscal year ending June 30, 2015 and the financial statements of the Municipality for the year ended June 30, 2014 were restated.

At the date of issuance of the basic financial statements of the Municipality, the ERS has not issued the corresponding audited financial statements as of June 30, 2020, nor the attachments required by GASB No. 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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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 Municipality participate. The Municipality 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 19).

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.

Also, the Municipality participates in a contributory defined contribution plan named "Programa Head Start Municipio Autónomo de Caguas Money Purchase Plan".

### 15) 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 13, 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, not from Municipality funds (see Note 20).

### 16) 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 GWFS. The GWFS utilize a net position presentation, which are categorized as follow:

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

- *Net Investment in Capital Assets* – These consists of capital assets, net of accumulated depreciation and amortization, reduced by the outstanding balances of bonds payable, notes payable and other debts that are attributed to the acquisition, construction or improvements of those assets. For the purposes of determining the outstanding debt attributed to capital assets, the total long-term debt related to the acquisition, construction or improvements of capital assets has been reduced by any related unspent debt proceeds and any related unamortized debt issuance costs. In addition, the outstanding debt attributed to capital assets does not include accrued interest payable, non-capital accrued liabilities, inter-fund loans and other financial assets.

  For Governmental Activities, Net Investment in Capital Assets is comprised of the following:

| | |
|---|---|
| Capital Assets, Net of Accumulated Depreciation | $375,722,916 |
| Outstanding Balance on Related Debt | (117,993,133) |
| Unspent Capital Debt Proceeds | 2,356,261 |
| Net Investment in Capital Assets | $260,086,044 |

- *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 consists of net position which does 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 Municipality will fund outlays for a particular purpose from both restricted (e.g., restricted bond 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 fund financial statements, a flow assumption must be made about the order in which the resources are considered to be applied. It is the Municipality's policy to consider restricted – net position to have been depleted before unrestricted – net position is applied.

***B) Fund Balance***

**Fund Balance Classification**

Fund balances for the governmental funds are reported in classifications that comprise a hierarchy based on the extent to which the Municipality honors constraints on the specific purposes for which amounts in those funds can be spent.

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

- *Restricted* – amounts with constraints placed on their use that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulation of other governments; or (b) imposed by law through constitutional provisions or enabling legislation.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

- *Committed* – amounts that can only be used for specific purposes determined by formal action of the Municipality's highest level of decision-making authority (Municipal Legislature) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation needs to occur no later than the close of the reporting period.

- *Assigned* – amounts that are constrained by the Municipality's intent to be used for specific purposes. The intent can be established at either the highest level of decision-making authority, or by a body or an official designated for that purpose.

- *Unassigned* – the residual classification for the Municipality's General Fund that includes amounts not contained in the other classifications. In other funds, the unassigned classification is used only if expenditures incurred for specific purposes exceed the amounts restricted, committed, or assigned to those purposes.

**Fund Balance Flow Assumption**

Sometimes the Municipality will fund outlays for a particular purpose from both restricted and unrestricted resources (the total committed, assigned, and unassigned fund balance). In order to calculate the amounts to report as restricted, committed, assigned, and unassigned fund balance in the GFFS a flow assumption must be made about the order in which the resources are considered to be applied. It is the Municipality's policy to consider restricted fund balance to have been depleted before using any of the components or unrestricted fund balance. Further, when the components of unrestricted fund balance can be used for the same purpose, committed fund balance is depleted first, followed by assigned fund balance. Unassigned fund balance is applied last.

**Fund Balance Policy**

The Municipality believes that sound financial management principles require that sufficient funds be retained by the Municipality to provide a stable financial base at all times. To retain this stable financial base, the Municipality needs to maintain a General Fund balance sufficient to fund all cash flows of the Municipality, to provide financial reserves for unanticipated expenditures and/or revenue shortfalls of an emergency nature, to provide funds for the disparity in timing between the collection of property taxes and other main income. The purpose of this policy is to specify the size and composition of the Municipality's financial reserves and to identify certain requirements for replenishing any fund balance reserves utilized.

**Restrictions of Fund Balance**

Restrictions of fund balance represent portions of fund balances that are legally segregated for a specific future use or are not appropriable for expenditure. The Municipality has implemented the provisions of the GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* as of July 1, 2010, in which it is required to classify and report amounts in the appropriate fund balance classification by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### Policy on Committing Funds

It is the policy of the Municipality that fund balance amounts will be reported as "Committed Fund Balance" only after formal action and approval by Municipal Legislature. The Municipal Legislature has the authority to separate funds for specific purposes. Any separate fund as Committed Fund Balance requires the adoption of a resolution by a simple majority of votes. The adoption of the resolution should be carried out before June 30 of the fiscal year to implement. If the actual amount of the commitment is not available through June 30, the resolution should establish the process or formula required to calculate the exact amount as soon as information is available in the following fiscal year.

For example, the Municipal Legislature may approve a resolution prior to year-end financial statements, if available, up to a specified dollar amount as Committed Fund Balance for capital projects. The exact dollar amount to be reported as Committed Fund Balance for capital projects may not be known at the time of approval due to the annual financial audit not yet being completed. This amount can be determined at a later date when known and appropriately reported within the year-end financial statements due to the Municipal Legislature approving this resolution before year-end.

It is the policy of the Municipality that the Municipal Legislature may commit fund balance for any reason that is consistent with the definition of Committed Fund Balance. Examples of reasons to commit fund balance would be to display intentions to use portions of fund balance for future capital projects, stabilization funds, or to earmark special General Fund revenue streams unspent at year-end that are intended to be used for specific purposes.

After approval by the Municipal Legislature, the amount reported as Committed Fund Balance cannot be reversed without utilizing the same process required to commit the funds. Therefore, it is the policy of the Municipality that funds can only be removed from the Committed Fund Balance category after resolution and approval by the Municipal Legislature.

### Policy on Assigning Funds

Funds that are *intended* to be used for a specific purpose but have not received the formal approval action at the Municipal Legislature level may be recorded as Assigned Fund Balance. Likewise, redeploying assigned resources to an alternative use does not require formal action by the Municipal Legislature. Having reviewed the requirements for assigning fund balance, therefore, is the policy of the Municipality that the Mayor shall have the authority to assign fund balance of the Municipality based on the intentions of the use of funds by the Municipal Legislature. In addition, the Mayor can delegate to the Finance Director or other employee of the Municipality, the authority to assign the funds.

### Policy on Unassigned General Fund Balance

It is the goal of the Municipality to achieve and maintain an Unassigned General Fund Balance equal to 15% of budgeted expenditures. The Municipality considers a balance of less than 10% to be a cause for concern, barring unusual or deliberate circumstances, and a balance of more than 20% as excessive. An amount in excess of 20% is to be considered for reservation to accumulate funding for the purchase of machinery and equipment, for capital projects, and/or reduces tax levy requirements, and shall be determined in conjunction with the annual budget process. In the event that the Unassigned General Fund Balance is less than the policy anticipates, the Municipality shall plan to adjust budget resources in the subsequent fiscal years to restore the balance.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Appropriation from Unassigned General Fund Balance shall require the approval of the Municipal Legislature and shall be only for specific disbursements, such as one-time expenditures and capital asset purchases, and not for ongoing expenditures unless a viable plan designated to sustain the expenditures is simultaneously adopted. The Municipality hasn't met its GASB 54 fund balance targets at June 30, 2020.

**Prioritization of Fund Balance Use**

In circumstances where the payment is for a purpose that quantities are available in multiple classifications of funds balance, the order in which resources will be used shall be as follows: Restricted Fund Balance, followed by Committed Fund Balance, Assigned Fund Balance, and last but not least, Unassigned Fund Balance.

### E. Interfund Transactions

Interfund transactions are reflected as loans, reimbursements or transfers. Loans are reported as receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. The Municipality has the following types of transactions among funds:

*Interfund Transfers* – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these advances, transfers, and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

*Intra-Entity Transactions* – There are two types of intra-entity transactions: First, the flow of resources between the primary government and its component units, and among the component units. This flow of resources and the related outstanding balances are reported as if they were external transactions. However, flow of resources between the primary government and blended component units are classified as interfund activity, as described above. Second, the intra-entity balances between the primary government and discretely presented component units that are tantamount to long-term debt financing. The primary government's liability is reported in the *Statement of Net Position*, the proceeds in the primary government's funds, and the asset in the discretely presented component units' *Statement of Net Position*. For the fiscal year, there are no intra-entity transactions.

### F. Risk Financing

Under Act No. 63 of June 21, 2010, the Legislative Assembly of the Commonwealth of Puerto Rico, authorized the municipalities to procure and manage at their own discretion all insurance policies, including those related to health plans been provided to the municipal employees. The Municipality also obtains medical insurance coverage from one health insurance company for its employees. Different health coverage and premium options are negotiated each year by the Municipality. Premiums are paid on a monthly basis directly to the insurance company.

The Municipality carries commercial insurance to cover property and casualty, theft, tort claims and other losses with private insurance company. Also, principal officials of the Municipality are covered under various surety bonds. Cost of insurance to the Municipality for the year ended June 30, 2020 amounted to $1,889,538, paid in full at the beginning of the fiscal year. The current insurance policies have not been cancelled or terminated.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

The Municipality obtains workers compensation insurance though the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth of Puerto Rico. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment. Cost of insurance allocated to the Municipality and deducted from the gross property tax collections by the MRCC for the year ended June 30, 2020 amounted to $1,092,956.

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

### G. Use of Estimates

The preparation of the financial statement in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported revenues and expenses during the reporting period. Actual results could differ from those estimates.

### H. Reclassifications

Various reclassifications have been made in the accompanying basic financial statements which affect the comparability with the basic financial statements issued for previous fiscal years.

### I. Subsequent Events

In preparing the financial statements, the Municipality's management consider events and transactions subsequent to June 30, 2020, that are determined to be significant and material that should be considered for financial statement purposes. Within this process, management consults with its legal counsel and performs monitoring procedures over significant receipts and disbursements and over the Municipal Legislature ordinances and resolutions, among other procedures.

### J. Accounting Standards Issued But Not Yet Adopted

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

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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

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

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

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

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

### I. 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 Municipality 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.

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.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

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.

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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

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

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

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

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

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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

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.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

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.

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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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:

- 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.

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

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

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

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

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

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

- 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

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

- 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.

**II. 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 Municipality 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.

<u>GASB Statement No. 87, *Leases*</u>. 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.

**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:

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

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

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

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

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

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

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

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

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

**SHORT-TERM LEASES**

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

**LESSEE ACCOUNTING**

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

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

### LESSSOR ACCOUNTING

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

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

### CONTRACTS WITH MULTIPLE COMPONENTS AND CONTRACT COMBINATIONS

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

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

### LEASE MODIFICATIONS AND TERMINATIONS

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

### SUBLEASES AND LEASEBACK TRANSACTIONS

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

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

### III. 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 Municipality is currently evaluating its accounting practices to determine the potential impact on the financial statements for the GASB Statements.

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

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

PPPS

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

continue

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation**

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.

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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

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

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

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

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

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

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

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## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

- 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.

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.

continue

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

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.

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

continue

## 3. ANNUAL REVENUES

### A. Property Taxes

The Municipal Revenue Collection Center (MRCC) is responsible for the billing of real property taxes and collections of both, personal and real property taxes on behalf of all the municipalities of Puerto Rico. The property tax is levied each year on the assessed value of the property at the beginning of the calendar year. Assessed values of real property are determined based on the market value existing as of 1957 and of personal property at the current value at the date of assessment. Prior to the beginning of each fiscal year, the MRCC informs the Municipality of the estimated amount of property taxes expected to be collected for the ensuing fiscal year. Throughout the year, the MRCC advances funds to the Municipality based on the initial estimated collections. The MRCC is required by law to prepare a settlement statement on a fiscal year basis, whereby a comparison is made between the amounts advanced to the Municipality and amounts actually collected from taxpayers. This settlement has to be completed on a preliminary basis not later than three months after fiscal year-end, and a final settlement made not later than six months after year-end. If the MRCC remits to the Municipality property taxes advances, which are less than the tax actually collected, a receivable from the MRCC is recorded on June 30. However, if advances exceed the amount actually collected, a borrowing from MRCC is recorded on June 30. For fiscal year 2019-2020, this difference was recorded as an unavailable revenue for the amount of $1,278,385.

Complete real property tax exoneration is granted by the Commonwealth of Puerto Rico on the first $15,000 of the assessed valuation of owner-occupied residential units. However, the Municipality receives the full amount of the exonerated tax base as of January 1, 1992, except for residential units assessed at less than $3,500 on which a complete exemption is granted. The personal property tax is self-assessed by the taxpayer on a return, which is to be filed and paid in full by May 15 of each year with the MRCC and based on current values as of December 31 of previous year. Complete exemption from personal property taxes up to an assessment of $50,000 is granted to retailers with an annual volume of net sales under $150,000. The Department of the Treasury, instead of the property taxpayer, becomes the source of payment in these cases.

The effective tax rate for the fiscal year ended June 30, 2020 is 10.33% for real property and 8.33% for personal property of which 1.03% of each class of property belongs to the Commonwealth of Puerto Rico. The Commonwealth of Puerto Rico also contributes an annual tax rate of 0.20% of the property tax collected. Taxpayers pay 10.33% for real property and 8.33% for personal property and the remaining 0.20% is paid by the Commonwealth's Secretary of the Treasury as a subsidy. As part of Act No. 83 of August 30, 1991, as amended, the exempt amount to be paid by the Puerto Rico Secretary of the Treasury to the Municipality was frozen as of January 1, 1992. The remaining percentage is distributed as follows:

1) 6.00% and 4.00% for real and personal property, represent the Municipality's basic property tax rate which is appropriated for general purposes and accounted for in the general fund. The basic property tax rate is segregated by MRCC and accounted for an equalization fund together with a percentage of the net revenues of the Puerto Rico electronic lottery and a subsidy from the Commonwealth of Puerto Rico. The equalization fund assures that every municipality receive at least an amount equal to the tax collected to its base year or prior year.

   The Commonwealth makes a contribution equivalent to .20% portion of the tax rates to compensate the municipality for a discount granted to the taxpayers. Accordingly, the tax rates imposed to the taxpayer for real and personal property are 10.33% and 8.33%, respectively.

2) 3.5% of each represents the ad valorem tax restricted for debt service and accounted for in the debt service fund.

continue

**3. ANNUAL REVENUES – continuation**

Since the collection of property taxes, for all of the Municipalities in Puerto Rico, is a responsibility of the MRCC, it shall report to the Municipality the estimated and actual property taxes collections, as well as the operational expense allocation to each local government. During the fiscal year ended June 30, 2020 the allocated expenses to the Municipality amounted to $1,257,852.

Section 5803(b) of Law No. 80 of the MRCC allows the municipalities to develop and carry on activities and programs to expedite the assessments of new constructions and existing properties not yet assessed. Accordingly, along with a covenant with the MRCC, the Municipality engaged into an initiative, in order to increase the tax base of assessed properties over which the tax rate is applied and to expedite the collection of the taxes receivable in arrears at the MRCC (there is no receivable recorded within the Municipality's general ledger). The Municipality contracted an external consulting firm to assist and expedite these services. Among the different types of services offered, the consulting firm has engaged into the process of assisting the MRCC to assess the new construction and other existing properties. These assessments will become then part of the MRCC tax roll register. This is the subsidiary of all properties assessed for tax purposes.

The new assessed properties are submitted for review and validation by the MRCC which proceeds to assign the assessed valuation and the tax to be imposed. Then, the MRCC determine those new properties that would to be added in the tax roll, either because they are from new construction or because are previous existing properties, with betterments identified but not reported previously. This process is performed either through physical inspections, knowledge of existent activities within the Municipality, and comparing the sales volume taxes returns (in case of commercial properties) with the property taxes returns, among other strategies. The updated information is delivered to the MRCC in order to be included within the tax roll for subsequent taxes levies.

Also, the consulting firm provides support to the Municipality by attending the taxpayers' request for services and by providing follow up on the MRCC taxes receivables in arrears. The purpose of these combined efforts is to improve the efficiency of the tax service and collections.

Ordinance Number 12A-48 was approved for the purpose of reviewing the tax incentives to the jurisdiction of the Municipality and the special development zone and other traditional urban center and authorizes the creation of a new code of socio-economic development incentives.

**<u>Personal Property</u>**

**Incentive Municipal on Personal Property Taxes – New Business**

- A 75% exemption on municipal taxes on real property for a period of five years.
- The downtown and development designated areas, would enjoy 100% exemption on municipal taxes on personal property for a period of two years, followed by a 90% exemption on municipal taxes on personal property for a period eight year.

**Incentive Municipal on Personal Property Taxes – Established Business**

- The exemption only applies to the personal property tax in excess of the average payment for such costs during the three years prior to the date of the application, which is referred to as personal property tax base period.
- The downtown and development designated areas, the personal property tax base period will be adjusted, reducing that amount by twenty percent (20%) annually until it is reduced to zero for the fifth taxable year.

continue

**3. ANNUAL REVENUES – continuation**

**Real Property**

**Incentive Municipal on Real Property Taxes – New Business**

- A 75% exemption on municipal taxes on real property for a period of five years and 40% exemption on municipal taxes on real property for a period of 10 years.

- The downtown and development designated areas, would enjoy a 90% exemption on real property for a period of 10 years.

**Incentive Municipal on Real Property Taxes – Established Business**

- The exemption only applies to the real property tax in the excess of the average payment for such costs during the three years prior to the date of the application, which is referred to as real property tax base period.

- The downtown and development designated areas, the real property tax base period will be adjusted, reducing that amount by twenty percent (20%) annually until it is reduced to zero for the fifth taxable year.

**B. Volume of Business Taxes**

The Municipality imposes a volume of business tax pursuant to Act No. 113 of July 10, 1974, on all business entities, which operate within the Municipality, which are not exempt from the tax pursuant to the Industrial Incentives Act. The tax is based on gross revenues, as defined by law, computed at the rate of 1.50% for financial institutions and savings and loans associations, and .50% for all other business entities.

The minimum gross revenue to file the Volume of Business Tax Declaration is $5,000 and the minimum tax payable is $25. The date to file the Volume of Business Tax Declaration is April 15 each year. Entities with sales volume of $3.0 million or more must include audited financial statements together with the tax return. The Municipality grants a five percent discount, if the taxes are paid on or before April 15. Otherwise, taxes are payable in two equal semi-annual installments on July 1 and January 1 following the date of levy. If they are paid with declaration on or before the due date, the taxpayer is granted a 5% discount. As a result of the COVID-19 pandemic, the filing date was changed to July 22, 2020. The volume of business tax receivable represents filed tax returns that were uncollected as of June 30, 2020, from prior years.

The following incentives related to Volume of Business Taxes were implemented with Ordinance 12A-48:

**Volume of Business Tax Incentive – New Business**

- A 75% exemption for a period of five years or a 40% exemption for a period of 10 years.

**Volume of Business Tax Incentive – Business Established**

- The exemption only applies to the business volume in excess of the average volume during the three years prior to the date of the application, which is referred to as base volume business. The volume of business tax attributable to the base volume business will be subject to regular tax rates.

- In the down town and development designated areas, the volume of business tax basis will be adjusted, reducing such amount by (20%) annually until it is reduced to zero for the fifth taxable year.

continue

## 3. ANNUAL REVENUES – continuation

Collections of volume of business tax revenues received mainly in April 15, are accounted as unearned revenues, since such collections have a time requirement and should be used starting July 1st of next fiscal year. In the next fiscal year, the unearned revenue is recognized as revenue, net of any credit or refunds payable to taxpayers.

### C. Sales and Usage Taxes

Municipality imposes a Sales and Usage Taxes of 1.0% collected and belong to the Municipality on the sales price of a taxable item or on the purchase price of all usage, storage or consumption of a taxable item (changes as per Act Number 18 of 2014). All merchants required to collect the Sales and Usage Taxes, are required to file a monthly Sales and Usage Taxes Return Form, no later than the 20th of the following month from the month being reported. The Act also provides for restrictions on the use of the resources to be invested in solid waste and recycling programs, capital improvements and health and public safety costs.

The amount collected by the Puerto Rico Secretary of Treasury will be deposited in accounts or special funds in FAFFA, subject to restrictions imposed and distributed as follows:

a. 0.2% will be deposited in a “Municipal Development Fund” to finance costs as restricted by the Act;

b. 0.2% will be deposited in a “Municipal Redemption Fund” to finance loans to municipalities subject to restrictions imposed by the Act; and

c. 0.1% will be deposited in a “Municipal Improvement Fund” to finance capital improvement projects. These funds will be distributed based on legislation from the Commonwealth’s Legislature.

Sales and Usage Taxes receivable represents filed sales tax returns that were collected subsequent to June 30, 2020 but pertaining to the current year period.

As per Act Number 18 of 2014 was created the "Law of Municipal Administration Fund (MAF)" to establish a special fund called the Municipal Administration, authorize municipalities to pledge the funds deposited in the Local Government Fund to which they are to secure the repayment of any loan, bond, note or other evidence of indebtedness, which are the source of repayment funds deposited in the Special Fund and to meet any expenditure budget of the Municipality and the Municipality any activity or project, authorize the Government Development Bank for Puerto Rico to make disbursements for purposes set out in this Act.

This measure is intended, first, to strengthen the financial capacity of the Corporation Tax Fund of Puerto Rico (COFINA, by Spanish acronyms), established under Law No. 91-2006, as amended, known as the "Law Fund of Sales and Usage Taxes", adjusting the sales and usage taxes (SUT) by increasing the state portion to 6.0% while the municipal SUT is reduced to 1.0%, effective February 1, 2014.

Through this legislation, a mechanism under which the SUT collections entitled to receive the Commonwealth of Puerto Rico each fiscal year, after complying with the deposits in the Tax Fund requires by Act No. 91-2006, shall be deposited in a special fund created for the benefit of, and assigned to the municipalities. This special fund is called the "Local Government Fund" ("LGF"), which will be guarded by FAFAA.

Also, on February 1, 2014 was enacted the Act No. 19 that creates the Municipal Financing Corporation (COFIM, by Spanish acronyms). The COFIM, attached to FAFAA, with the power to issue bonds or use other mechanisms to pay or refinance debt incurred by municipalities, the payment of principal and interest is backed by the municipal SUT.

continue

## 3. ANNUAL REVENUES – continuation

In addition, create the Redemption Fund of COFIM, to which the resources of the existing Municipal Fund Redemption will be transferred effective February 1, 2014, and facilitated the distribution of funds from the Municipal Redemption Fund, the Municipal Development Fund and the Municipal Improvement Fund. Provides that the first proceeds of the municipal SUT of 1% shall be collected by the Puerto Rico Treasury Department and deposited directly into the Redemption Fund of COFIM. Provides that bonds and notes issued by the COFIM be payable and secured by the pledge of a fixed amount, or municipal SUT corresponding to a fixed rate of 0.3% has been collected during the previous fiscal year, whichever is greater.

### D. Construction Excise Taxes

Ordinance 11-A-54 provides for a procedure for the administration and collection of construction excise tax, within the Municipality jurisdiction.

The construction excise tax generally is a self-assessed tax imposed over the cost of the project. The tax is paid by the taxpayer before the beginning of the construction project, if a permit is required to begin the construction, the taxpayer should file the tax return 30 days after the submission of the permit; otherwise, the file should be made at least 15 days before the construction activity. The activities covered by this tax and the exemption granted are as follows:

1) All construction will pay 6% of construction excise taxes.

2) Construction projects of detached properties (not part of a housing development), with a cost of $90,000 or less will pay 3% of construction excise taxes. If the cost exceeds the $90,000, the applicable rate will be 6% over the $90,000 cost.

3) All construction projects carried out whose owner is a bona-fide farmer, certified by the Department of Agriculture, have full exemption to the construction excise taxes.

4) Major repairs and improvements of detached properties occupied by their owner, for which cost don't exceed $15,000, have full exemption to the construction excise taxes. If related costs exceed $15,000, the excess over this amount will be subject to a 3% of construction excise tax.

5) All improvements made to commercial or private property in the down town, as well of major improvements to buildings, parks, prayer centers or studies of philosophic or human nature have full exemption to the construction excise taxes.

6) All construction projects carried out by not-for-profit organization or educational institutions have full exemption to the construction excise taxes.

## 4. CASH AND INVESTMENTS

### Cash in Banks

Puerto Rico laws authorize governmental entities to invest in direct obligations or obligations guaranteed by the federal government or the Commonwealth of Puerto Rico (*Statement of Uniform Investment Guidelines for the Municipalities of the Commonwealth of Puerto Rico*, issued by the GDB as promulgated by Act No. 113 of August 3, 1995). The Municipality is also allowed to invest in bank acceptances, other bank obligations and certificates of deposit in financial institutions authorized to do business under the federal and Commonwealth laws. During the year, the Municipality invested its funds in interest bearing bank accounts, and certificates of deposit.

continue

## 4. CASH AND INVESTMENTS – continuation

Under the laws and regulations of the Government, public funds deposited by the Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the Federal Deposit Insurance Corporation (FDIC) coverage. All securities pledged as collateral are held by agents designated by the Government's Secretary of the Treasury, but not in the Municipality's name.

Municipality follows the practice of pooling cash. On June 30, 2020, the pool cash account in commercial banks had a balance of $39.8 million of which $3.2 million in the General Fund, $8.6 million in the Capital Projects Fund, $161,891 in Health and Human Services Fund, and $4.9 million in Other Non-Major Funds. Any deficiency in the pooled cash account is assumed by the general fund and covered through future budgetary appropriation.

### Cash in with Fiscal Agent

Cash with Fiscal Agent in Popular Bank of Puerto Rico in the debt service fund consists principally of property tax collections and sales and usage taxes amounting to $20.3 million that are restricted for the payment of the Municipality's debt service, as required by law.

Cash with Fiscal Agent in the Capital Projects Fund of $1.8 million, consists of unspent proceed of bonds in private banks in Puerto Rico, and deposited on those banks, and are restricted to improvement of recreational facilities. The amount in Other Governmental Funds consist principally of unspent proceeds of bonds deposited in the private banking, that are restricted for different purposes.

### Restricted Cash in FAFAA

The Restricted Cash of $1.1 million in Capital Projects Fund consist principally of unspent proceeds of bonds that was restricted for the acquisition, construction or improvement of major capital assets will be used to amortize the original loans. As per GDB Restructuring Support Agreement (RSA), which became effective on April 6, 2018, as amended, the Municipality will be authorized to apply the full amount of deposits of loan held at GDB against the balance of any loan owed by the Municipality to GDB. After the implementation of the amendment to the RSA, on November 29, 2018, FAFAA issued a certification pursuant to Article 501 of Act No. 109-2017, as amended, applying the full cash amount held on GDB, in the amount of $13,957,839, against the loan balances owed by the Municipality to GDB. The balance of $1.1 million in cash account are pending to be applied or returned to the Municipality in accordance with the RSA. The RSA amendment is available on the Electronic Municipal Market Access website.

Municipality 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 Municipality on June 30, 2020:

### Concentration of Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. On June 30, 2020, the Municipality has invested only in cash equivalents of $39.8 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 Municipality in commercial banks must be fully collateralized for the amounts deposited in excess of the FDIC coverage. No investments in debt of equity securities were made during the Fiscal Year ended June 30, 2020. Therefore, the Municipality's management has concluded that the credit risk related to any possible loss related to defaults by commercial banks on the Municipality's deposits is considered low on June 30, 2020.

continue

## 4. CASH AND INVESTMENTS – continuation

### Custodial Credit Risk

This is the risk that, in the event of the failure of a depository financial institution, the Municipality will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party. Pursuant to the Investment Guidelines for the Commonwealth adopted by FAFAA, the Municipality may invest in obligations of the Commonwealth, obligations of the United States, certificates of deposit, commercial paper, banker's acceptance, or in pools of obligations of the municipalities of Puerto Rico, which are managed by FAFAA. On June 30, 2020, the Municipality has balances deposited in commercial banks amounting to $39.8 million which are insured by the FDIC up to the established limit and the excess are fully collateralized as explained above. Deposits in FAFAA, amounting to $1.1 million are uninsured and uncollateralized. It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk.

### 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 Municipality 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 bank's 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 Municipality'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 Municipality, the Municipality 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 Municipality's deposits is considered low on June 30, 2020.

## 5. UNEARNED REVENUES

Government-wide *Statement of Net Position* and Governmental Funds Balance Sheet reports *unearned* revenues for resources received before it has a legal claim to them; in connection with cash collected for revenues that are not considered to be available to liquidate liabilities of the current period, which corresponded to the follow:

| | | |
|---|---|---|
| **Governmental Funds:** | | |
| Federal Grants - COVID-19 Section 8 | $ | 181,900 |
| Volume of Business Taxes | | 762,251 |
| **Total Unearned Revenues** | $ | 944,151 |

continue

## 6. LOANS AND OTHER RECEIVABLES

Loan's receivables recorded in non-major governmental funds consists various loans issued to qualified participants for home buying and commercial loans provided with federal funds. This amount is presented net of estimated allowances for uncollectible amounts of $865,472, which were determined based upon past collection experience.

Other receivables in the amount of $359,382 are related to rent and other charges received after year end.

On October 20, 2014, the Municipality signed a Note Receivable for $1,050,000 in exchange for a land, in which an apartment building was constructed. The note is no-interest bearing, and the full payment will be received on October 24, 2054. In order to recognize the amortization of the present value of the note, the percentage used was a 6%, based on bonds issued by the Municipality in 2014.

## 7. INTERGOVERNMENTAL REVENUES, FEDERAL AND STATE GRANTS AND SUBSIDIES

Intergovernmental revenues consist primarily of funds received from the Commonwealth, "in lieu of tax" payments from the Quasi-Public Corporation, Puerto Rico Electric Power Authority (PREPA), and financial assistance received from state governments. Intergovernmental revenues are accounted for through the General Fund because they are not restricted for specific purpose.

Grants and subsidies received from the Commonwealth and federal agencies include, among others, a general subsidy for urban development and capital improvements. Intergovernmental revenues are accounted for through the General Fund except for those directly related to urban development and capital improvements, which are accounted for through the Special Revenues and the Capital Project Funds. Federal Financial Awards are recorded in the General Fund, Special Revenue Fund, Capital Projects Funds, and Health and Human Services Fund.

## 8. INTER-FUND TRANSACTIONS

### *A. Due from/to Other Funds*

Inter-fund receivables and payables generally reflect temporary loans, billings for services provided and recovery of expenditures. Following is a summary of inter-fund assets and liabilities as of June 30, 2020:

| Receivable Fund | Payable Fund | Amount |
|---|---|---|
| General Fund | Capital Projects Fund | $ 3,682,171 |
| | Health and Human Services Fund | 2,341,164 |
| | Other Governmental Funds | 320,964 |
| | | $ 6,344,299 |

The purpose of each inter-fund balances is the following:

Payables to the general fund:

Capital Projects Fund – includes expenditures mainly of the Capital Loans Funds, Community Development Block grants and other related projects sponsored by the Municipality, which are initially disbursed through the General Fund.

Health and Human Services Funds – includes expenditures mainly for payroll which were initially disbursed through the General Fund.

continue

## 8. INTER-FUND TRANSACTIONS – continuation

Other Governmental Funds – includes expenditures mainly to finance certain public safety, housing and health and welfare projects that involve both the use of federal and municipal funds and which were initially disbursed through the General Fund.

### *B. Transfers In/Out*

Inter-fund transfers in/out reflect the transfers of resources from one fund to another without the attempt of recovering such revenues. Following is a summary of inter-fund transfers for the year ended June 30, 2020:

| Transferred In | Transferred Out | Amount | Purposes |
|---|---|---|---|
| Debt Service Fund | General Fund | $ 5,921,431 | Payment of Interest and Principal of Debt |
| General Fund | Nonmajor Funds | 2,217 | Transfer of Equity |
| Health and Human Services Fund | Nonmajor Funds | 15,300 | Transfer of Equity |
| Capital Projects Fund | General Fund | 477,521 | Transfer of Equity |
| Nonmajor Funds | General Fund | 364,673 | Transfer of Equity |
| General Fund | Debt Service Fund | 881,640 | Transfer of Equity |
| Capital Projects Fund | Debt Service Fund | 1,497,037 | Transfer of Equity |
| | | $ 9,159,819 | |

## 9. DUE FROM GOVERNMENTAL UNITS

The due from governmental units for the fiscal year ended June 30, 2020 for the General Fund, corresponds to the follows:

| | AMOUNT |
|---|---|
| Municipal Revenues Collection Center - Final Liquidation | $ 1,278,385 |
| Municipal Revenues Collection Center - May and June Remittance Received in August 2020 | 92,812 |
| Puerto Rico Department of Public Transportation | 19,062 |
| Puerto Rico Department of Education | 37,674 |
| Other Agencies | 17,406 |
| Total Due from Governmental Units | $ 1,445,339 |

continue

## 10. FEDERAL GRANTS RECEIVABLE

The due from Federal grants for the fiscal year ended June 30, 2020, corresponds to the follows:

| | CAPITAL PROJECTS FUND | HEALTH AND HUMAN SERVICES FUND | OTHER NON MAJOR FUNDS | TOTAL GOVERNMENTAL FUNDS |
|---|---|---|---|---|
| Community Development Block Grants/Entitlements Grants | $ 2,967,061 | $ - | $ - | $ 2,967,061 |
| Head Start Program | - | 12,158,990 | - | 12,158,990 |
| Home Investment Partnership Program | - | - | 1,654,636 | 1,654,636 |
| Continuum of Care Program | - | - | 46,350 | 46,350 |
| Emergency Solutions Grants Program | - | - | 723,079 | 723,079 |
| Public Safety Partnerships and Communities Policing Grant | - | - | 30,020 | 30,020 |
| Child and Adult Care Food Program | - | - | 149,130 | 149,130 |
| Total Due to Governmental Units | $ 2,967,061 | $ 12,158,990 | $ 2,603,215 | $ 17,729,266 |

## 11. CAPITAL ASSETS

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

| DESCRIPTION | BALANCE JULY 1, 2019 | RECLASSI-FICATION | INCREASE | DECREASE | BALANCE JUNE 30, 2020 |
|---|---|---|---|---|---|
| Non-Depreciable Capital Assets: | | | | | |
| Land and Improvements | $ 93,262,982 | $ - | $ 147,043 | $ - | $ 93,410,025 |
| Construction in Progress | 1,923,246 | (772,362) | 3,260,867 | - | 4,411,751 |
| Works of Art | 2,645,189 | - | 15,240 | - | 2,660,429 |
| Total Non-Depreciable Capital Assets | 97,831,417 | (772,362) | 3,423,150 | - | 100,482,205 |
| Depreciable Capital Assets: | | | | | |
| Facilities and Improvements | 124,573,597 | 488,864 | 1,119,063 | - | 126,181,524 |
| Buildings and Improvements | 118,973,279 | 283,498 | 637,483 | - | 119,894,260 |
| Infrastructure | 415,827,891 | - | 65,230 | - | 415,893,121 |
| Equipment and Vehicles | 34,462,236 | - | 1,284,148 | (2,378,524) | 33,367,860 |
| Total Depreciable Capital Assets | 693,837,003 | 772,362 | 3,105,924 | (2,378,524) | 695,336,765 |
| Less Accumulated Depreciation: | | | | | |
| Facilities and Improvements | (72,750,331) | - | (3,452,981) | - | (76,203,312) |
| Buildings and Improvements | (61,097,186) | - | (2,272,072) | - | (63,369,258) |
| Infraestructure | (247,153,883) | - | (7,126,916) | - | (254,280,799) |
| Equipment and Vehicles | (26,277,428) | - | (2,197,747) | 2,232,490 | (26,242,685) |
| Total Accumulated Depreciation | (407,278,828) | - | (15,049,716) | 2,232,490 | (420,096,054) |
| Total Depreciable Capital Assets (Net) | 286,558,175 | 772,362 | (11,943,792) | (146,034) | 275,240,711 |
| **CAPITAL ASSETS, NET** | **$384,389,592** | **$ -** | **$ (8,520,642)** | **$ (146,034)** | **$375,722,916** |

continue

## 11. CAPITAL ASSETS – continuation

The Municipality's policy is to transfer construction in progress properly concluded to other classification of capital assets if such capital project is being used. Also, the detail of these amounts is presented in the previous table including the activity of the capital assets.

Depreciation expense for capital assets of governmental activities was charged to the following functions as follows:

| | AMOUNT |
|---|---|
| **Governmental Activities:** | |
| General Government | $ 628,782 |
| Public Safety | 286,233 |
| Public Works (Mainly Streets) | 7,499,262 |
| Culture and Recreation | 4,017,014 |
| Health and Welfare | 142,730 |
| Economic Development | 826,218 |
| Housing | 146,278 |
| Sanitation and Environmental | 157,694 |
| Education | 1,345,505 |
| Total Depreciation Expenses | $15,049,716 |

## 12. OTHER NON-CURRENT ASSETS

The Municipality reported during this year property held for future sale as other non-current assets. This property was acquired with the intent of selling them to low income families, constituents of the Municipality. As required by GASB No. 72, the Municipality assessed the fair value of this units on June 30, 2020 for $154,848.

The Municipality has the following recurring fair value measurements as of June 30, 2020:

| Units Held for Sale by Fair Value Leve | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Units Held for Sale | $ 154,848 | $ 154,848 | $ - | $ - |

Also, idle units held for future use were reported during this period given that property included in the schedules of construction in process remained with the same balance since prior year and no additions from construction were reported. Funds assigned to those projects were distributed for other purposes. In addition, a reclassification was made from buildings to idle units as a result of the damages to those properties last year.

continue

## 13. DEFERRED OUTFLOWS 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 Municipality recognized deferred outflows of resources in the government-wide and fund statements. These items are a consumption of net position by the Municipality 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.

At the end of the current fiscal year, the Municipality has an item that are reportable on the Government-wide *Statement of Net Position* that are relates to outflows from changes in the Net Pension Liability (Note 19), as follows:

| | |
|---|---|
| **Statement of Net Position:** | |
| Deferred Outflows of Resources | |
| Contributions to ERS | $ 37,650,339 |

## 14. DUE TO GOVERNMENTAL UNITS

The due to governmental units for the fiscal year ended June 30, 2020 for the General Fund, corresponds to the follows:

| | AMOUNT |
|---|---|
| Retirement System Administration | $ 179,767 |
| AEELA | 200,595 |
| Puerto Rico Power Authority | 456,828 |
| PR Aqueduct and Sewer System | 1,437,614 |
| Total Due to Governmental Units | $ 2,274,804 |

## 15. DEBT MARGIN

On March 9, 2009, the Commonwealth of Puerto Rico approves Act Number 7 that provides for revision of the valuation of property subject to taxation and imposes special property taxes for the Commonwealth. The legal debt margin of the Municipality is equal to 10% of the total property assessment located within the Municipality's jurisdiction.

As discussed on Notes 26 and 27 to the basic financial statements on pages 126 through 159, Puerto Rico fiscal crisis affects all instrumentalities, including municipalities. Actually, the Commonwealth does not have access to the finance market. The municipalities that obtained loans through the Governmental Development Bank (GDB), actually closed, or Commercial Banks with the endorsement of FAFAA. Under the GDB Restructuring Act the GDB transferred most of its loan assets to the GDB Debt Recovery Authority (DRA). The DRA is a new entity created by the GDB Restructuring Act for the purpose of receiving certain GDB assets, facilitate the restructuring of certain of GDB's indebtedness pursuant PROMESA and issuing new bonds. As part of the process, the DRA engaged AmeriNat as its loan servicer. As loan servicer, AmeriNat is now handling all matters relating to municipalities loans portfolio from DRA, including collection and posting of payments, certification of balances to auditors, and addressing any past due situations in the event the municipalities is unable to make scheduled payments.

Therefore, the determination of the Municipality's debt margin depends on the access to the markets, to which it does not have access, and Commercial Banking loans with the approval of FAFAA and the Oversight Board under Section 207 of PROMESA.

continue

## 16. LONG-TERM DEBTS

### A. General Obligations Bonds and Special Obligations Bonds

The principal long-term obligations of the Municipality are general obligation bonds and special obligation bonds issued to finance the construction and improvements of public facilities and purchase of machinery and equipment. The Municipality's obligations long-term debt retirements are appropriated and paid from resources accumulated in the Debt Service Fund (See Note 17).

The following is a summary of general and special obligation bonds of the Municipality as of June 30, 2020:

| Type of Obligation and Purpose | Issue Date | Original Borrowing | Maturity Date | Interest Rate | Balance Amount |
|---|---|---|---|---|---|
| **General Obligation Bonds:** | | | | | |
| **Property Taxes Income:** | | | | | |
| General Construction | 2000 | $ 10,350,000 | 2026 | 2.70% to 7.81% | $ 4,375,000 |
| General Construction | 2000 | 3,150,000 | 2024 | 2.70% to 7.81% | 1,180,000 |
| General Construction | 2002 | 9,845,000 | 2026 | 2.70% to 5.60% | 4,670,000 |
| General Construction | 2002 | 125,000 | 2026 | 2.70% to 5.60% | 35,000 |
| General Construction | 2002 | 1,360,000 | 2026 | 2.70% to 5.60% | 615,000 |
| General Construction | 2004 | 9,900,000 | 2028 | 1.61% to 5.31% | 4,995,000 |
| General Construction | 2004 | 1,575,000 | 2028 | 2.36% to 5.31% | 835,000 |
| General Construction | 2005 | 460,000 | 2029 | 2.53% to 5.31% | 255,000 |
| General Construction | 2005 | 370,000 | 2029 | 2.53% to 5.31% | 205,000 |
| General Construction | 2005 | 1,610,000 | 2024 | 4.17% to 5.28% | 565,000 |
| General Construction | 2005 | 1,640,000 | 2030 | 4.50% | 876,000 |
| General Construction | 2005 | 500,000 | 2030 | 4.75% | 271,000 |
| General Construction | 2006 | 11,020,000 | 2025 | 0.32% to 5.00% | 4,600,000 |
| General Construction | 2006 | 11,015,000 | 2025 | 0.52% to 5.00% | 4,610,000 |
| General Construction | 2007 | 8,060,000 | 2031 | 0.45% to 6.32% | 5,070,000 |
| General Construction | 2006 | 2,695,650 | 2031 | 4.75% | 1,570,650 |
| General Construction | 2007 | 7,575,000 | 2026 | 0.36% to 5.54% | 3,605,000 |
| General Construction | 2008 | 624,000 | 2030 | 4.50% | 352,000 |
| Operational Purpose | 2010 | 9,740,000 | 2034 | 4.75% to 7.50% | 627,782 |
| General Construction | 2012 | 18,285,000 | 2036 | 3.47% to 7.50% | 12,433,800 |
| General Construction | 2012 | 815,000 | 2021 | 3.36% to 7.50% | 163,000 |
| General Construction | 2012 | 245,000 | 2036 | 0.37% to 7.50% | 166,600 |
| General Construction | 2012 | 279,900 | 2037 | 4.50% | 225,000 |
| General Construction | 2013 | 3,120,000 | 2030 | 4.25% | 2,047,000 |
| Operational Purpose | 2014 | 9,450,000 | 2038 | 6.00% to 7.50% | 8,380,000 |
| Refinancing | 2017 | 26,855,000 | 2031 | 7.50% | 24,490,000 |
| Purchase of Equipment | 2019 | 900,660 | 2025 | 2.75% | 661,000 |
| Refinancing | 2019 | 4,810,000 | 2028 | 7.25% to 8.00% | 4,455,000 |
| Refinancing | 2019 | 8,555,000 | 2036 | 7.25% to 8.00% | 8,315,000 |
| Refinancing | 2019 | 18,200,000 | 2035 | 8.00% | 18,200,000 |
| **Subtotal** | | | | | **118,848,832** |

continue

**16. LONG-TERM DEBTS** – continuation

| Type of Obligation and Purpose | Issue Date | Original Borrowing | Maturity Date | Interest Rate | Balance Amount |
|---|---|---|---|---|---|
| **Special Obligations Bonds:** | | | | | |
| **General Revenues:** | | | | | |
| General Construction | 2002 | $ 2,065,000 | 2027 | 3.66% to 6.41% | $ 935,000 |
| General Construction | 2002 | 5,185,000 | 2027 | 3.66% to 6.41% | 2,330,000 |
| General Construction | 2002 | 15,385,000 | 2027 | 3.66% to 6.41% | 6,915,000 |
| General Construction | 2006 | 10,015,000 | 2025 | 5.00% to 5.58% | 3,480,000 |
| General Construction | 2007 | 8,575,000 | 2024 | 1.53% to 6.73% | 1,285,026 |
| General Construction | 2007 | 10,075,000 | 2026 | 5.84% to 6.07% | 4,415,000 |
| General Construction | 2008 | 3,185,000 | 2032 | 3.89% to 5.82% | 2,055,000 |
| General Construction | 2008 | 7,750,000 | 2024 | 4.16% to 5.72% | 2,495,000 |
| General Construction | 2009 | 6,802,000 | 2033 | 1.53% to 7.50% | 4,956,000 |
| Operational Purpose | 2015 | 3,850,000 | 2030 | 6.00% to 8.00% | 2,925,000 |
| **Subtotal** | | | | | **31,791,026** |
| **Sales & Usage Taxes:** | | | | | |
| General Construction | 2009 | 8,770,000 | 2033 | 1.48% to 7.50% | 6,282,479 |
| General Construction | 2009 | 542,000 | 2033 | 1.48% to 7.50% | 275,266 |
| General Construction | 2010 | 4,710,000 | 2034 | 4.75% to 7.50% | 3,698,212 |
| Operational Purpose | 2014 | 7,445,000 | 2038 | 6.00% to 7.50% | 4,975,277 |
| **Subtotal** | | | | | **15,231,234** |
| **Total Special Obligations Bonds** | | | | | **47,022,260** |
| **Total General and Special Obligations Bonds** | | | | | **$ 165,871,092** |

Principal and interest on the bonds are generally paid from amounts withheld by MRCC from the monthly property tax remittances and deposited in GDB until the payment to the bond holder.

On July 14, 2017, the Financial Oversight and Management Board for Puerto Rico (Oversight Board) created by Congress authorized the Government Development Bank for Puerto Rico (GDB) to pursue the restructuring of its debts under Title VI of PROMESA and conditionally certified GDB's Restructuring Support Agreement (RSA) under the relevant provisions of Title VI.

The Oversight Board's decision was in response to a Fiscal Agency and Financial Advisory Authority (FAFAA) request, dated June 30, 2017, in which the agency noted that the proposed restructuring, along with certain related settlements contemplated by the RSA, will result in an efficient wind down of GDB's operations and a comprehensive financial restructuring of GDB's obligations. FAFAA noted further that by proceeding under Title VI of PROMESA with the requisite creditor support, GDB believes that it will realize its objective of maximizing value for its stakeholders, while avoiding the delay, expense and uncertainty associated with litigation. Accordingly, under the GDB Restructuring Act the GDB transferred most of its loan assets to the GDB Debt Recovery Authority (DRA). The DRA is a new entity created by the GDB Restructuring Act for the purpose of receiving certain GDB assets, facilitate the restructuring of certain of GDB's indebtedness pursuant PROMESA and issuing new bonds.

continue

## 16. LONG-TERM DEBTS – continuation

As part of the process, the DRA engaged AmeriNat as its loan servicer. As loan servicer, AmeriNat is now handling all matters relating to municipalities loans portfolio from DRA, including collection and posting of payments, certification of balances to auditors, and addressing any past due situations in the event the municipalities is unable to make scheduled payments.

Variable interest rates on bonds are reviewed periodically by GDB and are based on the fluctuation of GDB's weighted average rate for its commercial paper program. Under this program, GDB issues commercial paper: (1) in the taxable and tax-exempt markets of the USA, and (2) to corporations having tax exemptions under the Puerto Rico Industrial Incentives Acts and, which qualify for benefits provided by the former Section 936 of the US Internal Revenue Code.

### Section 108 Loan – CDBG

Federal loan on June 30, 2020 consists of a note payable in annual installments fluctuating from $200,000 to $600,000 with variable bearing interest at 2.66%.

### Community Disaster Loan

The Community Disaster Loan (CDL) on June 30, 2018 was granted under Section 417 of the Stafford Act and FEMA Regulation 44 CFR §206.367 under major disaster declaration of September 20, 2017 for the Territory of Puerto Rico (FEMA-DR-4339-PR). The Promissory Note is at interest rate of 2.625% (the rate for five-year maturities as determined by the Secretary of Treasury in effect on the date the Promissory Note is executed, adjusted to the nearest 1/8 percent).

The following is a summary of changes in long-term debts of the Municipality for the year ended June 30, 2020:

| DESCRIPTION | BALANCE JULY 1, 2019 | NEW ISSUES | RETIREMENTS AND ADJUSTMENTS | BALANCE JUNE 30, 2020 | AMOUNTS DUE WITHIN ONE YEAR | AMOUNTS DUE AFTER ONE YEAR |
|---|---|---|---|---|---|---|
| **Governmental Funds:** | | | | | | |
| General Obligations Bonds | $ 126,514,532 | $ - | $ (7,665,700) | $ 118,848,832 | $ 8,091,700 | $ 110,757,132 |
| Special Obligations Bonds | 51,534,260 | - | (4,512,000) | 47,022,260 | 4,803,000 | 42,219,260 |
| Federal Loans | 600,000 | - | (600,000) | - | - | - |
| Community Disaster Loan | 5,000,000 | - | - | 5,000,000 | - | 5,000,000 |
| Net Pension Liability | 216,098,495 | - | - | 216,098,495 | - | 216,098,495 |
| Net OPEB Liability | 5,515,908 | - | - | 5,515,908 | - | 5,515,908 |
| Other Obligations | 21,468,740 | 10,093,322 | (6,390,259) | 25,171,803 | 7,264,208 | 17,907,595 |
| **TOTAL** | **$ 426,731,935** | **$ 10,093,322** | **$ (19,167,959)** | **$ 417,657,298** | **$ 20,158,908** | **$ 397,498,390** |

continue

## 16. LONG-TERM DEBTS – continuation

### B. Debt Compliance

There are a number of limitations and restrictions contained in the various bond indentures. The Municipality believes it is in compliance with all significant limitations and restrictions.

The annual requirements to amortize the noncurrent liabilities outstanding as of June 30, 2020, are as follows:

| | General Obligation Bonds | | Special Obligation Bonds | | Federal Loans | | Other Obligations | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| Year Ending June 30, | Principal Payment | Interest Payment | Principal Payment | Interest Payment | Principal Payment | Interest Payment | Principal Payment | Interest Payment | Principal | Interest |
| 2021 | $ 8,091,700 | $ 8,062,928 | $ 4,803,000 | $ 2,697,251 | $ - | $ - | $ 7,264,208 | $ 72,720 | $ 20,158,908 | $ 10,832,899 |
| 2022 | 8,911,700 | 7,549,185 | 5,121,000 | 2,655,877 | - | - | 662,172 | 68,601 | 14,694,872 | 10,273,663 |
| 2023 | 9,443,982 | 6,987,061 | 4,790,026 | 2,508,391 | - | - | 666,550 | 64,224 | 14,900,558 | 9,559,676 |
| 2024 | 9,874,200 | 6,388,556 | 5,036,000 | 2,198,366 | - | - | 78,703 | 59,571 | 14,988,903 | 8,646,493 |
| 2025 | 10,459,200 | 5,750,353 | 4,643,000 | 1,869,853 | - | - | 83,648 | 54,626 | 15,185,848 | 7,674,832 |
| 2026-2030 | 40,566,000 | 19,657,973 | 14,037,000 | 5,584,585 | - | - | 504,001 | 187,366 | 55,107,001 | 25,429,924 |
| 2031-2035 | 23,689,650 | 7,776,813 | 8,036,957 | 1,549,992 | - | - | 315,781 | 29,903 | 32,042,388 | 9,356,708 |
| 2036-2040 | 7,812,400 | 836,753 | 555,277 | 24,969 | - | - | - | - | 8,367,677 | 861,722 |
| Unmatured | - | - | - | - | 5,000,000 | - | 237,211,143 | 274,097 | 242,211,143 | 274,097 |
| **TOTAL** | **$ 118,848,832** | **$ 63,009,622** | **$ 47,022,260** | **$ 19,089,284** | **$ 5,000,000** | **$ -** | **$ 246,786,206** | **$ 811,108** | **$ 417,657,298** | **$ 82,910,014** |

### C. Arbitrage Rebate Requirement

According to Sections 103 and 148 through 150 of the US Internal Revenue Code and Sections 1.148 through 1.150 of the US Treasury Regulation, the Municipality's tax-exempt bonds are subject to the arbitrage rebate requirements. At June 30, 2020, the Municipality had no federal arbitrage liability on bonds since interest income earned from the investment of unspent bond proceeds were made in bank deposits that generate yields lower than the rates applicable to the debt service payments.

### D. Other Non-Current Liabilities

The following is a summary of changes in other non-current liabilities of the Municipality for the year ended June 30, 2020:

| DESCRIPTION | BALANCE JULY 1, 2019 | NEW ISSUES | RETIREMENTS AND ADJUSTMENTS | BALANCE JUNE 30, 2020 | AMOUNTS DUE WITHIN ONE YEAR | AMOUNTS DUE AFTER ONE YEAR |
|---|---|---|---|---|---|---|
| **Governmental Funds:** | | | | | | |
| Law No. 42-MRCC | $ 1,253,087 | $ - | $ (61,678) | $ 1,191,409 | $ 65,554 | $ 1,125,855 |
| PR Retirement System Administration | 5,914,550 | 1,033,792 | - | 6,948,342 | 1,626,292 | 5,322,050 |
| Claims and Judgments | 171,387 | - | (41,519) | 129,868 | 18,718 | 111,150 |
| MRCC-Property Taxes Liquidation | 149,233 | - | (149,233) | - | - | - |
| PR Health Insurance Administration (ASES) | - | 1,541,509 | - | 1,541,509 | 739,034 | 802,475 |
| Christmas Bonus | 830,363 | 831,646 | (830,363) | 831,646 | 831,646 | - |
| Retainage Liability | 141,979 | 261,858 | (38,995) | 364,842 | - | 364,842 |
| Compensated Absences | 13,008,141 | 6,424,517 | (5,268,471) | 14,164,187 | 3,982,964 | 10,181,223 |
| **TOTAL** | **$ 21,468,740** | **$ 10,093,322** | **$ (6,390,259)** | **$ 25,171,803** | **$ 7,264,208** | **$ 17,907,595** |

continue

## 16. LONG-TERM DEBTS – continuation

### Due to Municipal Revenue Collection Center

The Act No. 42 dated January 2000 allows the Municipal Revenue Collection Center (MRCC, as per its Spanish acronyms) to issue debt based on the disbursements made in excess to the municipalities on their final liquidation prior to fiscal year 2000. The municipalities agreed to repay MRCC such loans in semi-annual installments plus accrued interest. In connection with Law 42 the Municipality issued a note payable to MRCC in the amount of $1,876,000 payable in 30 years plus interest at a semi-annual rate of 3.0938%.

### PR Retirement System Administration

The GWFS, Statement of Net Position, includes approximately $6.9 million in the governmental activities for the amount notified by the Retirement System Administration to the Municipality, related to the uniform additional contribution. The General Fund have been used to liquidate the liability for this concept.

### Accrued Legal Claims

This amount represents the amount accrued for possible claims arising from litigations as recommended by the Municipality's attorneys and classified as due after one year. Only claims presented as due within one year when the Municipal Legislature approved it in the next fiscal year budget.

### PR Health Insurance Administration (ASES)

The GWFS, Statement of Net Position, includes approximately $1.5 million in the governmental activities for the amount notified by the Puerto Rico Health Insurance Administration to the Municipality, related to the Government Health Insurance Program "Vital". This amount will be paid with the excess of CAE distributed by the MRCC during Fiscal Year 2020-2021.

### Christmas Bonus

This amount represents the estimated accrued Christmas bonus accumulated as of June 30, 2020 and payroll related benefits, representing the benefit to employees to be paid during the last week of November 2020.

### Retainage Liability

This amount represents the amount retained on construction contracts that should be paid upon termination of the contracted projects.

### Compensated Absences

The GWFS, Statement of Net Position, includes approximately $14.2 million in the governmental activities for the estimated accrued vacation benefits, accrued sick leave benefits and payroll related benefits, representing the Municipality's commitment to fund such costs from future operations. The General Fund have been used to liquidate the liability for this concept.

continue

## 17. DEBT RETIREMENT

Revenues of the Debt Service Fund consist of the ad-valorem property taxes which are recognized as revenue when collected from taxpayers and reported by the MRCC to the Municipality (See Note 3).

These property taxes are accumulated by the MRCC in costs of the general obligation bonds issued by the Municipality (See Note 16). Payments are made to the GDB from such accumulated funds by the MRCC.

As per Act Number 18 of 2014 was created the "Law of Municipal Administration Fund (MAF)" to establish a special fund called the Municipal Administration, authorize municipalities to pledge the funds deposited in the Local Government Fund to which they are to secure the repayment of any loan, bond, note or other evidence of indebtedness, which are the source of repayment funds deposited in the Special Fund and to meet any expenditure budget of the municipality and the municipality any activity or project, authorize the Government Development Bank of Puerto Rico to make disbursements for purposes set out in this Act.

This measure is intended, first, to strengthen the financial capacity of the Corporation Tax Fund of Puerto Rico (COFINA, by Spanish acronyms), established under Law No. 91-2006, as amended, known as the "Law Fund of Sales and Usage Taxes", adjusting the sales and usage taxes (SUT) by increasing the state portion to 10.5% while the municipal SUT is reduced to 1.0%, effective February 1, 2014. Through this legislation a mechanism under which the SUT collections entitled to receive the Commonwealth of Puerto Rico each fiscal year, after complying with the deposits in the Tax Fund requires by Act No. 91-2006, shall be deposited in a special fund created for the benefit of, and assigned to the municipalities. This special fund is called the "Local Government Fund" ("LGF"), which will be guarded by the Government Development Bank of Puerto Rico.

Also, on February 1, 2014 was enacted the Act No. 19 that creates the Municipal Financing Corporation (COFIM, by Spanish acronyms). The COFIM, attached to the Government Development Bank (GDB), with the power to issue bonds or use other mechanisms to pay or refinance debt incurred by municipalities, the payment of principal and interest is backed by the municipal SUT.

In addition, it created the Redemption Fund of COFIM, to which the resources of the existing Municipal Fund Redemption will be transferred effective February 1, 2014, and facilitated the distribution of funds from the Municipal Redemption Fund, the Municipal Development Fund and the Municipal Improvement Fund. Provides that the first proceeds of the municipal SUT of 1% shall be collected by the Treasury Department and deposited directly into the Redemption Fund of COFIM. Provides that bonds and notes issued by the COFIM be payable and secured by the pledge of a fixed amount, or municipal SUT corresponding to a fixed rate of 0.3% has been collected during the previous fiscal year, whichever is greater.

On July 14, 2017, the Financial Oversight and Management Board for Puerto Rico (Oversight Board) authorized the GDB Restructuring Act under which the GDB transferred most of its loan assets to the GDB Debt Recovery Authority (DRA). The DRA is a new entity created by the GDB Restructuring Act for the purpose of receiving certain GDB assets, facilitate the restructuring of certain of GDB's indebtedness pursuant PROMESA and issuing new bonds.

As part of the process, the DRA engaged AmeriNat as its loan servicer. As loan servicer, AmeriNat is now handling all matters relating to municipalities loans portfolio from DRA, including collection and posting of payments, certification of balances to auditors, and addressing any past due situations in the event the municipalities is unable to make scheduled payments.

continue

## 18. DEFERRED 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 Municipality recognized deferred inflows of resources in the government-wide and fund statements. These items are an acquisition of net position by the Municipality 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 Municipality has an item that are reportable on the government-wide *Statement of Net Position* that are relates to inflows from changes in the Net Pension Liability (Note 19).

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 Inflows of Resources reported in the basic financial statements were as follows:

| | |
|---|---|
| **Statement of Net Position:** | |
| Deferred Inflows of Resources | |
| Unamortized Investment in ERS | $ 27,080,407 |

| | |
|---|---|
| **Balance Sheet:** | |
| Commonwealth of Puerto Rico | $ 1,278,385 |
| Federal Grants: | |
| Capital Projects Fund | 2,085,357 |
| Health and Human Services Fund | 10,595,112 |
| Other Governmental Funds | 2,097,855 |
| Total Deferred Inflows of Resources | $ 16,056,709 |

## 19. PENSION PLANS

As further described in Note 2 D 12, the Municipality implemented GASB Statement No. 68, Accounting and Financial Reporting for Pension, during fiscal year 2015, 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.

### A. Employee's Retirement System of the Government of the Commonwealth of Puerto Rico

#### *1. 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 Municipality 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.

continue

**19. PENSION PLANS** – **continuation**

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).

Act No. 106-2017 closed participation in ERS to new members effective July 1, 2017, and moved prospective accruals for all current active members to a separate defined contribution plan outside the ERS. This summary details the provisions under Act No. 3-2013, which was effective July 1, 2013 and under which the benefits to be paid to ERS members are determined. Certain provisions are different for the three groups of members who entered ERS prior to July 1, 2013 as described below:

- Members of Act No. 447-1951 are generally those members hired before April 1, 1990 (Defined Benefit Program)

- Members of Act No. 1 are generally those members hired on or after April 1, 1990 (Act No. 1-1990) and on or before December 31, 1999 (Defined Contribution Program)

- Members of Act No. 305 are generally those members hired on or after January 1, 2000 and on or before June 30, 2013 (Define 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 Contributory Hybrid Program, and were rehired on or after July 1, 2013, become members of the Defined Contributory 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.

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 Commonwealth does not guarantee benefits at retirement age.

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

### *2. Eligibility for Membership*

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

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

continue

**19. PENSION PLANS – continuation**

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

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

***3. Definitions***

a. **Fiscal Year**: A Fiscal Year is a 12-month period beginning on July 1 and ending on June 30 (Article 1-104).

b. **General Fund**: The General Expenses Budget of the Government of the Commonwealth of Puerto Rico.

c. **Government of Puerto Rico or Government**: The Government of the Commonwealth of Puerto Rico, its departments, divisions, bureaus, offices, agencies and dependencies (Article 1-104).

d. **Public Enterprise**: Anu government instrumentality of the People of Puerto Rico (Article 1-04).

e. **Municipality**: The Municipality of San Juan (Article 1-104).

f. **Employer**: The Government of Puerto Rico, any public enterprise that has effected to participate in the System, or any municipality that has elected to participate in the System (Article 1-104 and 1-110).

g. **Employee**: Any officer or employee of the Employer regularly employed on a full time basis (Article 1-104).

h. **Creditable Service for Act No. 447-1951 members:** the years and months for plan participation, during which contributions have been made, beginning on the later of date of hire or January 1, 1952 and ending on date of separation from service. For purposes of calculating Creditable Service, the following schedule shall apply:

| Service During a Fiscal Year | Creditable Service Earned |
|---|---|
| 15 days during the same month | 1 month |
| 2 months and 15 days to 5 months and 14 days | ½ year |
| 5 months and 15 days to 8 months and 14 days | ¾ year |
| 8 months and 15 days to 12 months | 1 year |

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

continue

**19. PENSION PLANS – continuation**

Months in which less than 15 days of service are rendered do not count towards Creditable Service (Article 1-106).

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

i. **Creditable Service for Act No. 1-1990 members**: the years and completed months of plan participation, during which contributions have been made, beginning on date of hire and ending on date of separation from service (Article 1-106 and 2-109). For purposes of calculating Creditable Service, the following schedule shall apply:

| Service During a Fiscal Year | Creditable Service Earned |
|---|---|
| Less than 3 months | None |
| 3 to 5 months | ½ year |
| 6 to 8 months | ¾ year |
| 9 months or more | 1 year |

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

j. **Compensation**: The gross cash compensation, excluding bonuses and overtime, upon which contributions by a Member to the Fund are based (Article 1-104).

k. **Average Compensation for Act No. 447-1951**: The average of the 3 highest years (36 highest months) of compensation that the participant has received for Creditable Service (Article 1-104).

l. **Average Compensation for Act No. 1-1990**: The average of the 5 highest years of compensation that the participant has received for Creditable Service. If annual compensation in the averaging period exceeds by more than 10% the annual compensation in the immediately preceding year, the compensation in excess of said 10% shall not be included in the calculation of Average Compensation (Article 2-108).

m. **Contributions**: The amount deducted from the compensation of a Member and the employer (Section 781).

n. **Regular Interest**: The interest rate as prescribed by the Board of Trustees (Article 1-104). The rate of 2.50% has always been in effect.

o. **Accumulated Contributions**: The sum of all amounts deducted from the compensation of a Member prior to July 1, 2013 with regular Interest (article 1-104).

p. **Actuarial Equivalent**: Equality in value such that the present value of the amount under any form of payment is essentially the same as the present value of the amount under the normal form of annuity payment for single participants. Actuarially Equivalent factors are determined based on annuity and mortality tables adopted by the Board of Trustees based on the system's experience and in accordance with the recommendations of the actuary.

continue

**19. PENSION PLANS** – continuation

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

q. **Public Officers in High-Risk Positions**: The Commonwealth of Puerto Rico Police, the Municipal Police, the Commonwealth Firefighter Corps, the Municipal Firefighter Corps, and the Custody Officers Corps.

r. **Social Security Retirement Age (SSRA)**: The Social Security Retirement Age varies based on the year of birth as indicated in the table below.

| Year of Birth | Social Security Retirement Age |
|---|---|
| 1937 or earlier | 65 years |
| 1938 | 65 years and 2 months |
| 1939 | 65 years and 4 months |
| 1940 | 65 years and 6 months |
| 1941 | 65 years and 8 months |
| 1942 | 65 years and 10 months |
| 1943 to 1954 | 66 years |
| 1955 | 66 years and 2 months |
| 1956 | 66 years and 4 months |
| 1957 | 66 years and 6 months |
| 2958 | 66 years and 8 months |
| 1959 | 66 years and 10 months |
| 1960 and later | 67 years |

s. **Retirement Savings Account**: The individual retirement account established for each member of System 2000 (Article 1-104). Each member has a nonforfeitable right to the value of his Retirement Savings Account (Article 3-107).

t. **Credits to Retirement Savings Accounts**: The credits to the retirement savings account include (1) any initial transfer balance for transferred participants, (2) contributions of the members to System 2000, and (3) the investment yield for each semester of the fiscal year based on the investment alternatives elected by the member (Article 3-107).

u. **Investment Alternatives for Retirement Savings Account**: System 2000 members could choose to allocate their Retirement Savings Account, in multiples of 10%, to the following investment options prior to July 1, 2013. Changes in allocation could have been made annually, effective each July 1.

   i. Fixed income – The yield is equal to the average monthly yield of the Two-Year Constant Maturity Treasuries during each semester of the fiscal year.
   ii. System's Investment portfolio – The yield is equal to 90% (75% prior to July 1, 2004) of the investment portfolio yield of the System during each semester of each fiscal year minus management fees such as fees payable to administrators of the portfolio.
   iii. Other alternatives adopted by the Board of the System.

v. **Defined Contribution Hybrid Contribution Account**: The individual account established for each active member as of July 1, 2013 and for each future member thereafter. Each member has a nonforfeitable right to their contributions to the Defined Contribution Hybrid Contribution Account and, for the System 2000 members, the initial transfer of their Retirement Savings Account as of June 30, 2013.

continue

## 19. PENSION PLANS – continuation

w. **Credits to Defined Contribution Hybrid Contribution Account**: The credits to the retirement savings amount include (1) the Retirement Savings Accounts as of June 30, 2013 for System 2000 members, (2) contributions by all members from July 1, 2013 to June 30, 2017 to ERS, and (3) the investment yield for each semester of the fiscal year as determined by the Board. The investment yield determined by the Board shall never be less than 80% of the investment portfolio yield of the System during each semester of each fiscal year minus management fees such as, but not limited to, fees payable to administrator of the portfolio, safekeeping of securities and investment counseling. With the move to Pay-As-You-Go funding under Act 106-2017, no credits are applied after June 30, 2017.

### *4. Coordination with Social Security for Act No. 447-1951 members*

Except for police, mayors and employees of the Agricultural Extension Service of the U.P.R., participants may elect to coordinate coverage under the System with Federal Social Security by selecting the lower of two contribution options. Those participants selecting Option (1), the Coordination Plan, are subject to a benefit recalculation upon attainment of Social Security Retirement Age. Those participants selecting Option (2), the Supplementation Plan, will continue to receive the same benefits for life, without any adjustments at SSRA. At any time up to retirement, participants may change from Option (1) to Option (2) by making a contribution including interest to the System, retroactive to the later of July 1, 1968 or the date of plan entry, that will bring their employees of the Agricultural Extension Service of the U.P.R. are covered under Option (2), the Supplementation Plan.

### *5. Retirement Benefits*

a. *Eligibility for Act No. 447-1951 Members:* Act No. 447-1951 members who were eligible to retire as of June 30, 2013 continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 447-1951 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 58 with 10 years of credited service, (3) any age with 30 years of credited service, (4) for Public Officers in High Risk Positions (the Commonwealth Police and Firefighter Corps, the Municipal Police and Firefighter Corps and the Custody Office Corps), attainment of age 50 with 25 years of credited service, and (5), for Mayors of municipalities, attainment of age 50 with 8 years of credited service as a Mayor. In addition, Act No. 447-1951 members who attained 30 years of credited service by December 31, 2013 are eligible to retire at any time.

Act No. 447-1951 members who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire upon attainment of the retirement eligibility age shown in the table below with 10 years of credited service.

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

In addition to the requirements in the table above, Act No. 447-1951 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 and did not attain 30 years of credited service by December 31, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

continue

**19. PENSION PLANS – continuation**

b. *Eligibility for Act No. 1-1990 Members:* Act No. 1-1990 members who were eligible to retire as of June 30, 2013, continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 1-1990 members could retire upon (1) attainment of age 55 with 25 years of credited service, (2) attainment of age 65 with 10 years of credited service, (3) for Public Officers in High Risk Positions, any age with 30 years of credited service, and (4) for Mayors, attainment of age 50 with 8 years of credited service as a Mayor.

Act No. 1-1990 members who were not eligible to retire as of June 30, 2013 are eligible to retire upon attainment of age 65 with 10 years of credited service. In addition, Act No. 1-1990 Public Officers in High Risk Positions who were not eligible to retire as of June 30, 2013 are eligible to retire directly from active service upon the attainment of age 55 with 30 years of credited service.

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

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

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

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

e. *Benefit:* An annuity payable for the lifetime of the member equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447-1951 and Act No. 1-1990 members, the accrued benefit determined as of June 30, 2013. If the balance in the hybrid contribution account is $10,000 or less, it shall be paid as a lump sum instead of as an annuity.

f. *Accrued Benefit as of June 30, 2013 for Act No. 447-1951 Members* – The accrued benefit as of June 30, 2013, shall be determined based on the average compensation, as defined, for Act No. 447-1951 members, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 447-1951 Mayors, the highest compensation, as defined, as a Mayor is determined as of June 30, 2013.

If the Act No. 447-1951 member had at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting to coordinate with social security (the Coordination Plan), the benefit is re-calculated at the Social Security Retirement Age (SSRA), as defined, as 1.5% of average compensation up to $6,600 multiplied by years of credited service, up to 30 years, plus 65% (75% if member was at least age 55 as of June 30, 2013) of average compensation in excess of $6,600.

continue

**19. PENSION PLANS – continuation**

If the Act No. 447-1951 member had less than 30 years of credited service as of June 30, 2013, and attains 30 years of credited service by December 31, 2013, the accrued benefit equals 55% of average compensation if the member was under age 55 as of June 30, 2013 or 60% of average compensation if the member was at least age 55 as of June 30, 2013. For participants selecting the Coordination Plan, the benefit is re-calculated at SSRA as 1.5% of average compensation up to $6,600 multiplied by years of credited service, up to 30 years, plus 55% (60% if member was at least age 55 as of June 30, 2013) of average compensation in excess of $6,600. Member contributions received from Act No. 447-1951 members eligible for this transitory benefit during the period beginning July 1, 2013 and ending upon the attainment of 30 years of credited service are considered pre-July 1, 2013 contributions; the contributions to the hybrid contribution account begin after the member attains 30 years of credited service.

If the Act No. 447-1951 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1.5% of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. Except for Commonwealth Police and Commonwealth Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58. For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to $6,600 multiplied by years of credited service up to 20 years, plus 1.5% of average compensation in excess of $6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of $6,600 multiplied by years of credited service in excess of 20 years. Except for Police and Firefighters, the benefit is actuarially reduced for each year payment commences prior to age 58.

For Act No. 447-1951 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation, as defined, as a Mayor for each year of credited service as a Mayor up to 10 years, plus 1.5% of highest compensation as Mayor for each year of non-Mayor credited service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayor credited service in excess of 20 years. Non-Mayor credited service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

g. *Accrued Benefit as of June 30, 2013 for Act No. 1-1990 Members:* The accrued benefit as of June 30, 2013 shall be determine based on the average compensation for Act No. 1 member, the years of credited service, and the attained age of the member all as of June 30, 2013. For Act No. 1-1990 Mayors, the highest compensation as a Mayor is determined as of June 30, 2013.

If the Act No. 1-1990 member is a police officer or firefighter with at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 65% of average compensation if the member was under age 55 as of June 30, 2013 or 75% of average compensation if the member was at least age 55 as of June 30, 2013.

For all other Act No. 1-1990 members, the accrued benefits equal 1.5% of Average Compensation multiplied by years of Creditable Service. The benefit is actuarially reduced for each year payment commences prior to age 65.

For Act No. 1-1990 Mayors with at least 8 years of credited service as a mayor, the accrued benefit will not be less than 5% of highest compensation as a Mayor for each year of credited service as a Mayor up to 10 years, pus 1.5% of highest compensation as Mayor for each year of non-Mayoral Credited Service up to 20 years, plus 2.0% of highest compensation as Mayor for each year of non-Mayoral Credited Service in excess of 20 years. Non-Mayoral Credited Service includes service earned as a Mayor in excess of 10 years. Maximum benefit is 90% of highest compensation as a Mayor.

continue

**19. PENSION PLANS – continuation**

h. *Compulsory Retirement:* All Act No. 447-1951 and Act No. 1-1990 Public Officers in High Risk Positions must retire upon attainment of age 58 and 30 years of credited service. A two-year extension may be requested by the member from the Superintendent of the Puerto Rico Police, the Chief of the Firefighter Corps, or supervising authority as applicable.

***6. Termination Benefits***

***a. Lump Sum Withdrawal***

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

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

***b. Deferred Retirement***

*Eligibility:* A member is eligible upon termination of service with 5 or more years of service (10 years of Credited Service for Act No. 447-1951 and Act No. 1-1990 members) prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal of the Accumulated Contributions and the Defined Contribution Hybrid Contribution Account.

*Benefit:* An annuity payable for the lifetime of the member commencing at the applicable retirement eligibility age equal to the annuitized value of the balance in the hybrid contribution account at the time of retirement, plus, for Act No. 447-1951 and Act No. 1-1990 members, the accrued benefit determined as of June 30, 2013.

***7. Dead Benefits***

***a. Pre-Retirement Death Benefit***

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

*Benefit:* A refund of the hybrid contribution account, plus the accumulated contributions for Act No. 447-1951 and Act No. 1-1990 members.

***b. High-Risk Death Benefit under Act No. 127-1958***

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

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

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

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

continue

**19. PENSION PLANS – continuation**

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

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

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

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

*Benefit:* The benefit is as follows (Act No. 105-1969, as amended by Act No. 4-2017):

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

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

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

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

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

For all members, the excess, if any, of the hybrid contribution account, plus the accumulated contributions for Act No. 447-1951 and Act No. 1-1990 members, at the time of retirement over the total annuity payments paid to the member and any beneficiary per the terms of the optional form of payment shall be payable to a beneficiary or the member's estate.

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

continue

**19. PENSION PLANS – continuation**

### *8. Disability Benefits*

#### *a. Disability*

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

*Benefit:* The balance of the hybrid contribution account payable as lump sum distribution, an immediate annuity or a deferred annuity at the election of the participant. Act No. 447-1951 and Act No. 1-1990 members remain eligible to receive the accrued benefit as of June 30, 2013 commencing at the applicable retirement eligibility age.

#### *b. High-Risk Death Benefit under Act No. 127-1958*

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

*Benefit:* 80% (100% for Act No. 447-1951 members) of compensation as of date of disability, payable as an annuity. If the member dies while still disabled, this annuity benefit continues to his beneficiaries. Beneficiaries include the surviving spouse and/or disabled children (for life), nondisabled children until age 18 (age 25 if pursuing studies), and the parents if no other beneficiaries. Effective July 1, 1996 and subsequently every three years, the disability benefit is increased by 3% provided that the member (or beneficiary) had been receiving payments for at least three years (Act No. 127-1958, as amended). The cost of these benefits is paid by the Commonwealth's General Fund.

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

#### *d. Disability Insurance*

The Administrator, with the approval of the Board, shall establish a disability benefits program, which shall provide a temporary annuity in the event of total and permanent disability. Disability benefits may be provided through one or more disability insurance contracts with one or more insurance companies authorized by the Insurance Commissioner of Puerto Rico to conduct business in Puerto Rico. The determination as to whether a person is partially or totally and permanently disabled, shall be made by the insurance company that issues the insurance policy covering the person. All the participants of the Program who are employees shall avail themselves to the disability benefits program in the manner and form established by the Administrator. During fiscal year 2019-2020 the disability insurance amounted to $50,392.

### *9. Minimum Benefits*

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

continue

**19. PENSION PLANS – continuation**

b. *Minimum Benefit for Members who Retired before July 1, 2013 (Act No. 156-2003, Act No. 35- 2007, and Act No. 3-2013)*: The minimum monthly lifetime income for members who retired or become disabled before July 1, 2013 is $500 per month effective July 1, 2013 ($400 per month effective July 1, 2007 and $300 per month up to June 30, 2007). The increase in the minimum monthly benefit from $200 per month to $300 per month is paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees. The increase in the minimum monthly benefit from $300 per month to $400 per month is to be paid by the ERS for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

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

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

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

***11. Special "Bonus" Benefits***

a. *Christmas Bonus (Act No. 144-2005, as Amended by Act No. 3-2013):* An annual bonus of $200 for each retiree, beneficiary, and disabled member paid in December provided the member retired prior to July 1, 2013. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

b. *Medication Bonus (Act No. 155-2003, as Amended by Act No. 3-2013):* An annual bonus of $100 for each retiree, beneficiary, and disabled member to cover health costs paid in July provided the member retired prior to July 1, 2013. Evidence of coverage is not required. This amount is prorated if there are multiple beneficiaries. This benefit is paid from the supplemental contributions received from the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

continue

## 19. PENSION PLANS – continuation

### 12. Contributions

**a.** ***Member Contributions***: Not applicable. Eliminated July 1, 2017 by Act No. 106-2017.

From July 1, 2013 to June 30, 2017, contributions by members are 10% of compensation. However, for Act No. 447-1951 members who selected the Coordination Plan, the member contributions are 7% of compensation up to $6,600 plus 10% of compensation in excess of $6,600 during the 2013-2014 fiscal year and 8.5% of compensation up to $6,600 plus 10% of compensation in excess of $6,600 during the 2014-2015 fiscal year. Members may voluntarily make additional contributions to their hybrid account.

Prior to July 1, 2013, contributions by Act No. 447-1951 members selecting the Coordination Plan were 5.775% of compensation up to $6,600 plus 8.275% of compensation in excess of $6,600. Contributions by all other members were 8.275% of compensation. System 2000 members may also have voluntary contribution of up to 1.725% of compensation prior to July 1, 2013.

**b.** ***Employer Contributions***: Not applicable. Eliminated July 1, 2017 by Act No. 106-2017.

Formerly – Prior to July 1, 2011, employer contributions were 9.275% of compensation. On July 6, 2011, the Commonwealth enacted Act No. 116, increasing the employers' contributions rate from 9.275% to 10.275% of employee compensation for fiscal year 2011-2012, an additional 1% annually for each of the next four years, and 1.25% annually for each of the five years thereafter, reaching an aggregate contribution rate of 20.525% effective July 1, 2020 (Article 2-116 as amended by Act No. 116-2011 and Act No. 3-2013).

**c.** ***Supplemental Contributions from the Commonwealth's General Fund, Certain Public Corporations, and Municipalities***

Effective July 1, 2013, the ERS will receive a supplemental contribution of $2,000 each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefiting as an Act No. 447-1951 or Act No. 1-1990 member while an active employee. This supplemental contribution will be paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees *(Act No. 3-2013)*.

**d.** ***Additional Uniform Contributions***: Not applicable. Eliminated July 1, 2017 by Act No. 106-2017.

Formerly – During the 2013-2014 fiscal year, the System will receive an Additional Uniform Contribution of $120 million. During each year from 2014-2015 through 2032-2033 the System will receive an Additional Uniform Contribution certified by the external actuary of the System as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below $1 billion. The AUC will be paid by the Commonwealth's General Fund, public corporations with own treasuries, and municipalities (Act No. 32-2013).

continue

## 19. PENSION PLANS – continuation

### *13. Service Purchase*

Prior to July 1, 2013, active members with eligible service from prior employment may elect to purchase service in ERS. The cost of the purchase is calculated by applying the ERS statutory contribution rates to the member's salary during the years of service at the former employer. The amount due to member contributions is accumulated at 9.5% per year (6% prior to April 4, 2013) until 6 months after the time of the service purchase request. Any amount not covered by asset transfers from the member's prior pension fund is payable by the member (Act No. 10-1992, Act No. 14-1981, Act No. 122-2000, Act No. 33-2007 and Act No. 203-2007). Effective July 1, 2013, only veterans may purchase service for time spent under military service are permitted to make voluntary contributions to the Defined Contribution Hybrid Contributory Account during the years of military leave prior to July 1, 2017.

### *14. Early Retirement Programs*

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

While the General Fund / Public Corporation is paying the pension benefit to the member or any surviving beneficiary, the General Fund / Public Corporation will also pay a contribution equal to the employer contribution rate [12.275% for the 2013-2014 fiscal year plus the employee contribution rate for Public Corporation (currently 10%)] of final salary to the ERS. The employer contribution rate applied to final salary increases as under Act No. 116-2010 to a rate of 20.525% of payroll in 2020-2021 and thereafter. Under Section 4C if Act No. 70-2010, active members who had at least 30 years of service could retire immediately and receive a bonus equal to six months of salary (paid by Commonwealth). For any active employee who retired under Section 4C, the Public Corporation will pay a contribution equal to the employer contribution rate (12.275% for 2013-2014 fiscal year, increasing to 20.525% in 2020-2021 and thereafter) plus the employee contribution rate (currently 10%) of final salary to the ERS for five years after retirement.

### *15. Changes in Plan Provisions since Prior Valuation*

Act No. 106-2017 closed participation in ERS to new members effective July 1, 2017, and moved prospective accruals for all current active members to a separate defined contribution plan outside of ERS. The following contributions were eliminated July 1, 2017 by Act No. 106-2017:

- Act No. 116-2011 Employer Contributions
- Act No. 32-2013 Additional Uniform Contribution
- Act No. 3-2013 Supplemental Contributions
- Member Contributions

continue

## 19. PENSION PLANS – continuation

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

#### *(1) Net Pension Liability*

Effective July 1, 2014, the Municipality implemented the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27,* and GASB Statement No. 71*, Pension Transition for Contributions Made Subsequent to the Measurement Date-an amendment of GASB Statement No. 68,* which significantly changed the Municipality's accounting for pension amounts. The information disclosed below is presented in accordance with these new standards. The Municipality's net pension liability was measured as of June 30, 2016, later audited financial information. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as June 30, 2016.

The Municipality 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, 2016, and the Total Pension Liability for each plan program used to calculate the Net Pension Liability was determined by an actuarial valuation as of June 30, 2015, calculated based on the discount rate and actuarial assumptions and was then projected forward to June 30, 2016. The Municipality's proportion of the Net Pension Liability was based on a projection of the Municipality'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, 2018, the Municipality's proportional share of the Net Position Liability used was as follows:

| | |
|---|---|
| Proportion - June 30, 2016 | 0.62621% |
| Proportion - June 30, 2017 | 0.63153% |
| Change - Increase (Decrease) | 0.00532% |

As June 30, 2018, the Municipality reported $216,098,495 (June 30, 2017 base) as Net Pension Liability for its proportionate shares of the Net Pension Liability of ERS.

| Net Pension Liability | June 30, 2018 | |
|---|---|---|
| | Total | Proportional Share (0.63153%) |
| Total Pension Liability | $ 32,109,294,000 | $ 202,780,257 |
| Fiduciary Net Position (Deficit) | (2,108,880,000) | (13,318,238) |
| Net Pension Liability | $ 34,218,174,000 | $ 216,098,495 |
| Plan's Fiduciary Net Position (Deficit) of Total Pension Liability | -6.57% | -6.57% |
| Covered Payroll | $ 3,344,197,000 | $ 21,119,652 |
| Net Pension Liability as a % of Covered Payroll | 1023.21% | 1023.21% |

#### *(2) Pension Expense*

For the fiscal year ended June 30, 2020, the Municipality recognized pension expense of $6,968,773 of total pension payments of the pay-as-you-go charge.

continue

**19. PENSION PLANS – continuation**

### *(3) Deferred Outflows/Inflow of Resources*

As of June 30, 2020, the Municipality 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 | $ - | $ - |
| Differences between actual and expected experience | 145,987 | 3,824,453 |
| Changes in assumptions | 28,249,902 | 21,993,658 |
| Change in employer's proportion and differences between the employer's contributions and the employer's proportionate share of contributions | 9,254,450 | - |
| Net differences between projected and actual earnings on plan investments | - | 1,262,296 |
| Total | $ 37,650,339 | $ 27,080,407 |

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.

| Year Ended June. 30, | Amount |
|---|---|
| 2021 | $ (2,113,986) |
| 2022 | (2,113,986) |
| 2023 | (2,113,986) |
| 2024 | (2,113,986) |
| 2025 | (2,113,985) |
| Thereafter | - |
| Total | $ (10,569,930) |

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

**Actuarial Methods and Assumptions**

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

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

continue

**19. PENSION PLANS – continuation**

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

A summary of the actuarial assumptions and methods used to calculate the total pension liability as of June 30, 2016 is provided below, including any assumptions that differ from those used in the June 30, 2015 actuarial valuation. Total pension liability represents the portion of the actuarial present value of projected benefit payments attributable to past periods of service for current and inactive employees.

The actuarial valuation used the following actuarial assumptions:

| | |
|---|---|
| Actuarial Assumptions: | |
| Inflation | 2.5% |
| Investment Rate of Return | Not applicable due to Pay-As-You-Go funding. As of June 30, 2016 was 6.55%. |
| Municipal Bond Index | 3.58%, as per Bond Buyer General Obligation 20 — Bond Municipal Bond Index |
| Discount Rate | 3.58% |
| Projected Salary Increases | 3.00% per year. No compensation increases are assumed until July 1, 2021 as of result of Act No. 3-2017 four year extention of the Actt No. 66-2014 salary freeze and the current general economy. |
| Mortality | Pre-retirement Mortality:<br>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.<br>100.0% of deaths while in active service are assumed to be occupational for members covered under Act No. 127. |
| | Post-retirement Healthy Mortality:<br>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:<br>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. |

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

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

continue

**19. PENSION PLANS – continuation**

### Long-Term Expected Rate of Return

The investment return assumption is no longer applicable due to Pay-As-You-Go funding. As of June 30, 2016 it was 6.55% per annum, net of investment expenses.

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

### 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. After June 30, 2017, the Commonwealth enacted legislation that changed the structure of pension administration managed by ERS. For further information regarding such pension legislation, see Note 2.

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

The discount rate on June 30, 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 | | |

As directed by the ERS, the asset basis for the date of depletion projection is the ERS's net assets (the gross assets less the Pension Obligation Bond proceeds). On this basis, net assets were exhausted in the 2014-2015 fiscal year and no projection was needed to be performed as of June 30, 2016, as the tax-free municipal bond index applies in all years, and is thus the single equivalent interest rate that is used as the discount rate in the determination of the Total Pension Liability.

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.

continue

## 19. PENSION PLANS – continuation

| Changes in Net Pension Liability | Increase (Decrease) | | | |
|---|---|---|---|---|
| | Total Pension Liability | Plan Fiduciary Net Position | Net Pension Liability | Proportional Share |
| Balance as of June 30, 2016 | $ 36,432,873,000 | $ (1,265,885,000) | $ 37,698,758,000 | $ 238,079,474 |
| Changes for the year: | | | | |
| Service Cost | 628,025,000 | - | 628,025,000 | 3,966,175 |
| Interest on Total Pension Liability | 1,034,186,000 | - | 1,034,186,000 | 6,531,209 |
| Effect of Plan Changes | - | - | - | - |
| Effect of Economic/Demographic (Gains) or Losses | (248,414,000) | - | (248,414,000) | (1,568,812) |
| Effect of Assumptions Changes or Inputs | (4,179,110,000) | - | (4,179,110,000) | (26,392,390) |
| Benefits Payments | (1,558,266,000) | (1,558,266,000) | - | - |
| Administrative Expenses | - | (26,142,000) | 26,142,000 | 165,093 |
| Other Expenses | - | (394,324,000) | 394,324,000 | 2,490,280 |
| Costs of Bonds | - | (198,084,000) | 198,084,000 | 1,250,963 |
| Member Contributions | - | 320,095,000 | (320,095,000) | (2,021,500) |
| Net Investment Income | - | 92,188,000 | (92,188,000) | (582,196) |
| Employer Contributions | - | 921,538,000 | (921,538,000) | (5,819,801) |
| **Balance as of June 30, 2017** | **$ 32,109,294,000** | **$ (2,108,880,000)** | **$ 34,218,174,000** | **$ 216,098,495** |

ERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, ERS expects to continue using a discount rate net of administrative expenses for GASBS's No. 67 and No. 68 calculations through at least the 2017-2018 fiscal year. ERS will continue to check the materiality of the difference in calculation until we have changed our methodology.

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

The following presents the Municipality's proportionate share of the Net Pension Liability, calculated using the discount rate, as well as what the Municipality'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:

| | 1% Decrese 2.58% | Current Discount Rate 3.58% | 1% Increse 4.58% |
|---|---|---|---|
| Total Pension Liability | $ 217,818,723 | $ 202,780,257 | $ 167,722,556 |
| Fiduciary Net Position (Deficit) | (13,318,238) | (13,318,238) | (13,318,238) |
| Net Pension Liability | **$ 231,136,961** | **$ 216,098,495** | **$ 181,040,794** |

continue

## 19. PENSION PLANS – continuation

### Payable to the Pension Plan

On June 30, 2020, the Municipality reported a payable of $7,128,109 for the outstanding amount of contributions to the pension plan as follows: Fiscal Year 2016-2017 $4,137,050 and Fiscal Year 2017-2018 $1,777,500; for Fiscal Year 2019-2020 $179,767 for members contribution and $1,033,792 for the Pay-As-You-Go system.

The Fiscal Plan for Puerto Rico was approved by the Oversight Board of PROMESA (see Note 28) on March 13, 2017. The approval was conditioned on the Puerto Rico government and the Board reaching an agreement to reduce benefit payments of the following systems by 10% in the aggregate:

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

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

### Pay-As-You-Go Funding

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

Subsequently, on August 23, 2017, the Governor signed into law the "Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants" (Act No. 106-2017), which reformed the Commonwealth Retirement Systems. Act. No. 106-2017 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. 106-2017 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 through 2021.

Furthermore, Act No. 106-2017 modified the ERS's governance. Under Act No. 106-2017, 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. 106-2017 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. 106-2017, 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. 8-2017.

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:

continue

## 19. PENSION PLANS – continuation

- Contributions to ERS are primarily based on statutory percentage of payroll.

- Disbursements are comprised of benefit payments, administrative expenses, and Pension Obligation Bond debt service.

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

- If the budget is set based on expected contributions and disbursements, in the event of adverse experience during the fiscal year, should provide for additional funds from the sponsoring employers.

- If the ERS be permitted to develop a budget request of a "pay-go" amount for the fiscal year that includes a margin to provide a buffer against adverse outcomes.

- And how would the impacts of specific management decisions be handled.

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

**Pension Plan Fiduciary Net Position**

As per June 30, 2016 Actuarial Valuation Report Updated issued on October 23, 2018, the Actuaries state: "PRGERS net assets became negative in the 2014-2015 fiscal year. If the increasing Act 116-2011 employer contributions, the Supplementary Contribution under Act 3-2013, and the Additional Uniform Contribution under Act 32-2013 (as amended by Act 244-2014) are not paid in full on an annual basis, PRGERS will continue being rapidly disfunded and gross assets will be exhausted."

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

### B. Pension Plan of Defined Contributions of the Head Start Program of the Autonomous Municipality of Caguas Money Purchase Plan

Effective January 1, 2002, the Municipality created a retirement plan Head Start Program of the Autonomous Municipality of Caguas Money Purchase Plan (the Plan) for all employees of whose salaries were funded with the Head Start Program and which have at least one year of service and are age twenty-one or older. The Plan is part of the Popular Master Defined Contribution Retirement. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and Sections 1081.01 (a) of the Puerto Rico Internal Revenue Code of 2011, as amended. Popular Bank of Puerto Rico serves as the Plan Trustee.

continue

## 19. PENSION PLANS – continuation

The Municipality is required to contribute three percent (3%) of the employees' annual compensation. The Municipality complied with this required contribution percentage for the current and past two years. Participants may contribute based on after tax contributions amounts representing up to ten percent (10%) of the aggregate compensation paid to the employee, excluding the Christmas Bonus.

Participants are immediately vested in their contributions plus actual earnings thereon. Vesting is based on years of continuous service. On June 30, 2020, the Plan has 400 active participants. The participant vesting schedule on such portion of their accounts is described below:

| Completed years of service | Vested percent |
|---|---|
| Less than 3 years | 0% |
| At least 3 years | 20% |
| At least 4 years | 40% |
| At least 5 years | 60% |
| At least 6 years | 80% |
| At least 7 years | 100% |

The vesting provisions consider years of service before the employer established this Plan.

On termination of service due to death, disability or retirement, a participant or beneficiary may elect to receive a lump-sum amount equal to the value of the participants vested interest in his/her account, or maintain the funds in the Plan. Also, ten years' annuities are allowed under the plan. The normal retirement age is the latter of the date a participant attains his 65th birthday or the fifth anniversary of the first day of the plan year in which he/she commenced participation in the Plan. Early retirement distributions are not permitted. Under the provisions of the Plan, participants are not permitted to withdraw any amount contributed by the employer from the plan, unless separated from employment.

Total contributions to the Plan for fiscal year ended December 31, 2019 (the last available financial information) were $311,997 (Sponsor) and benefits paid were $144,200. Investment revenues were $49,010 and net appreciation in fair value of investments were $370,490, for a net increase in Plan Assets of $431,854. As of December 31, 2019, the Net Fund Assets of the Plan is $3,445,083.

Additional information on the Plan is provided in its financial statements for the year ended December 31, 2019, a copy of which can be obtained from in this report or requests for additional information should be directed to: Autonomous Municipality of Caguas, Office of the Mayor, P.O. Box 907, Caguas, Puerto Rico, 00726-0907, or http://www.caguas.gov.pr.

## 20. OTHER POSTEMPLOYMENT BENEFITS (OPEB)

In addition to the pension benefits described in Note 19 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.

continue

## 20. OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

### *Healthcare Benefits*

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

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

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

### *Christmas Bonus Benefits*

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

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.

continue

## 20. OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

### *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 (0.51671%) |
| Total OPEB Liability | $ 1,067,502,659 | $ 5,515,908 |
| Covered Payroll | N/A | N/A |
| Total OPEB Liability as a % of Covered Payroll | N/A | N/A |

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

| | |
|---|---|
| Proportion - June 30, 2016 | 0.51662% |
| Proportion - June 30, 2017 | 0.51671% |
| Change - Increase (Decrease) | 0.00009% |

### *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 Municipality with the audited schedules of employment allocations and OPEB amounts by employer as of June 30, 2020 (Municipality'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.

continue

## 20. OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

| Changes in Net Pension Liability | Total Pension Liability | Proportional Share |
|---|---|---|
| Balance as of June 30, 2016 | $ 1,374,395,292 | $ 7,101,657 |
| Changes for the year: | | |
| Service Cost | - | - |
| Interest on Total Pension Liability | 37,890,871 | 195,787 |
| Effect of Plan Changes | - | - |
| Effect of Economic/Demographic (Gains) or Losses | (13,831,526) | (71,469) |
| Effect of Assumptions Changes or Inputs | (240,534,656) | (1,242,870) |
| Benefits Payments | (90,417,322) | (467,197) |
| **Balance as of June 30, 2017** | **$ 1,067,502,659** | **$ 5,515,908** |

### *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.

continue

## 20. OTHER POSTEMPLOYMENT BENEFITS (OPEB) – continuation

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

The following presents the Municipality's proportionate share of the Total OPEB Liability calculated using the discount rate, as well as what the Municipality'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% |
|---|---|---|---|
| **Net OPEB Liability** | **$ 6,069,435** | **$ 5,515,908** | **$ 5,047,928** |

## 21. COMMITMENTS

### Construction and Improvement Commitments

| Fund | Encumbered For | Amount | Reported within Fund Balance Classification |
|---|---|---|---|
| Capital Projects Fund | Construction of Retaining Wall in Bo. Villa Coqui | $ 9,227 | Restricted for Infrastructure Improvement |
| | Construction of Idamaris Gardens Basketball Court | 45,907 | Restricted for Building and Facilities |
| | Improvements to the Champions Park | 41,735 | Restricted for Building and Facilities |
| | Construction of Borinquen Atravezada Basketball Court | 153,895 | Restricted for Building and Facilities |
| | Improvements to "Complejo Deportivo del Este" | 42,173 | Restricted for Building and Facilities |
| | Total | $ 292,937 | |

### Operating Leases

The Municipality leases various properties and equipment under operating lease agreements, which generally have terms of one year or less and are automatically renewed if sufficient funds are available. Lease agreements covering periods in excess of one-year are cancelable at the Municipality's option upon 30 days written notice to the lesser. Expenditures for the year ended June 30, 2020 amounted to approximately $474,578.

Future operating lease commitments are scheduled as follows:

| Operating Leases Fiscal Year | Amount |
|---|---|
| 2021 | $ 1,126,415 |
| 2022 | 987,138 |
| 2023 | 320,197 |
| 2024 | 67,897 |
| Total | $ 2,501,647 |

### Solid Waste Disposal Contract

The Municipality formalized a contract for the recollection and disposal and management of solid waste with a private entity (the Company). The original contract was amended effective July 1, 2014 for the following services and is due on December 31, 2021. Such contract requires the Municipality to pay the Company $11.50 per unit served. The contract provides for a minimum of 45,500 units served. Also, the fee paid to the Company will increase annually by five percent (5.0%) until December 31, 2021. Vegetable material requires the Municipality to pay the Company $9.99 per cubic yard with an annual increase of two-point five percent (2.5%).

continue

## 21. COMMITMENTS – continuation

In addition, the Municipality is agreed to pay an additional $32.00 per tons of solid waste that the Municipality transports and deposits in the Company's recollection center for processing. The fee is also subject to an annual increase of two-point five percent (2.5%). The Municipality is agreed to pay an additional $25.00 per tons of solid waste that the Municipality transports and deposits directly in landfill facilities by the Municipality. The fee is also subject to an annual increase of two-point five percent (2.5%).

The Municipality received royalty of $2.21 per tons for direct private collection in the recollection facilities. The royalty is also subject to an annual increase of three percent (3%). The Company also should collect recyclable material in 28,561 units for $3.24 per unit. The fee is also subject to an increase to $3.33 in fiscal year 2019, $3.43 in fiscal year 2020, and $3.54 in fiscal year 2021.

Expenditures for the year ended June 30, 2020 for this service under the terms of this contract amounts to approximately $7.3 million.

Future commitments under the terms of this contract are estimated as follows:

**Solid Waste Disposal Contract**

| Fiscal Year | Amount |
|---|---|
| 2021 | $ 23,705,181 |
| 2022 | 11,852,591 |
| Total | $ 35,557,772 |

### Other Commitments

On June 30, 2020, the non-major Special Revenue Funds had a deficit of $1,200,404 as follows: Housing Funds $3,205, Social & Welfare Activities Fund $603,315, MASS Transit Fund $4,030 and Economic Development Activities Fund $589,854. The deficits resulted from the accrual of expenditures without accruing intergovernmental and federal revenues for reimbursement of expenditures. As required by current standards, the Municipality recorded intergovernmental and federal revenues for reimbursement-based (expenditure-driven) grants on GFFS when all applicable eligibility requirements have been met and the resources are available. Any amount not covered by the corresponding award will be covered with future budgetary appropriations of the general fund, if necessary.

The Municipality has entered into various agreements to provide professional and consulting services, health services, repairs and maintenance of facilities, marketing and other miscellaneous services to its constituents.

### Contributions to Nonprofits Corporations

Act No. 137 of August 9th, 2002 amended Article 17.001 and added Article 17.016 to the 1991 Autonomous Municipalities Law No. 81 of the Commonwealth of Puerto Rico. This amendment authorizes Municipalities "to be part of, participate, support and sponsor nonprofit organizations under the General Law of Corporations of 1995, as amended, and as long as it is organized to promote economic and cultural development or social improvement of a municipality or region of which the municipality is part of and the corporation counts with the participation and engagement of, in addition of the municipalities, the different sectors composed of higher level educational institutions and industrial and commercial enterprises, including associations grouping businesses and industries. Municipalities' participation on the Board of Directors cannot exceed 1/3 of the total members".

continue

## 21. COMMITMENTS – continuation

Under this Article, the Autonomous Municipality of Caguas, participates in various forms with (1) Corporación de Bellas Artes de Caguas (COBAC); (2) Corporación de Salud Aseguradora por Nuestra Organización Solidaria, Inc. (SANOS); (3) Corporación de Conservación Etnoecológica Criolla, Inc. (CCECI); (4) Iniciativa Tecnológica Centro-Oriental, Inc. (INTECO); (5) Banco de Desarrollo Centro Oriental, Inc. (BADECO); (6) Centro Criollo de Ciencia y Tecnología del Caribe, Inc. (C3TEC); (7) Alianza Municipal Servicios Integrados (AMSI); and (8) Corporación Juvenil para el Desarrollo de Comunidades Sostenibles (CJDCS).

On October 8, 2004 representatives of the Municipality and COBAC signed a 15-year lease contract, transferring the operations of the Fine Arts Center (FAC) to COBAC effective July 1, 2004 for a $1,000 annual rental fee payable to the Municipality. In addition, the Municipality is scheduled to make annual contributions for 5 years at par with the commitments that each representative on the Board has agreed to contribute. Subsequently, COBAC would obtain and provide the financial resources necessary for its operations from resources other than the Municipality. Finally, the Municipality's representation on the Board of Directors is 4 out of 17 members, or 24% of the voting power. During this fiscal year, the Municipality contributed $20,000.

On July 1, 2006 representatives of the Municipality and SANOS signed a 5-year lease contract for the facilities where SANOS is currently located for a $1 annual fee payable to the Municipality. More recently, during the fiscal year 2019-2020 the Municipality contributed $80,000 to SANOS for education and drug prevention services.

On April 18, 2007 representatives of the Municipality and CCECI signed a 10-year lease contract for the land and facilities comprising the Caguas Botanical and Cultural Garden for an annual fee of $1,000 effective April 18, 2007. The Municipality agreed to contribute (1) operation funds for $500,000 for each fiscal year 2007-2008 and 2008-2009; $350,000 for fiscal years 2009-2010 and 2010-2011; $350,000 for fiscal year 2011-2012; (2) payment of utilities corresponding to the land and facilities included in the contract; (3) payment of the applicable insurance policies as the owner of the land and facilities; and (4) remaining funds assigned to the development of the Garden in the various dependencies/departments within the Municipality until June 30, 2007. During the fiscal year 2019-2020, the Municipality made contributions to CCECI for a total of $182,300 to cover operating expenses. In addition, in fiscal year 2015-2016, CCECI entered in a loan agreement with BADECO in the amount of $100,000, with an outstanding balance on June 30, 2020 of $51,449.

On September 3, 2003 representatives of the Caguas and other Municipalities signed a contractual agreement with INTECO to contribute funds; property; social, human, physical and technological capital from time to time. After the initial contribution, each Municipality would contribute approximately $1 per person annually according to the most recent Census available. The Municipality of Caguas and INTECO have and will enter into contractual agreements for specific projects from time to time. Finally, the Municipality's representation on the Board of Directors does not exceed the 1/3 of the total members. During fiscal year, the Municipality contributed $1,030,187 to cover operating expenses.

On July 1st, 2010, Banco de Desarrollo Centro Oriental, Inc. (BADECO) came to its existence as the only Regional Community Bank in Puerto Rico. BADECO is a nonprofit organization created and funded by the Autonomous Municipality of Caguas (MAC) as a spinoff of what was known for 27 years as the Community Development Bank of Caguas.

Out of this affiliation, BADECO administers for the MAC the loan programs that were not able to be transferred due to their nature of their funding, which came from Federal Government agencies, such as business loan fund granted by the Economic Development Administration (EDA) and the Energy Efficiency Loan fund for home owners granted by the Federal Department of Energy (DOE). BADECO reports to the MAC the programs performance and holds all the documentation regarding such programs. These programs are audited yearly by the MAC and are also open to audit procedures for the funding agencies. During fiscal year 2017-2018, BADECO made a loan in the amount of $86,000 from cash deposit in the Bank, in addition, during this fiscal year, another loan was made in the amount of $73,490, and in fiscal year 2019-2020 a new loan of $95,857 was made. These loans are non-interest bearing, no repayment has been made on these loans.

continue

## 21. COMMITMENTS – continuation

On March 26, 2012 representation of Municipality and Board of Directors signed a contractual agreement where the Municipality authorized Centro Criollo de Ciencia y Tecnología del Caribe, Inc. (C3TEC) to manage and operate such property. C3TEC is an interactive educational center intended to awaken the curiosity and stimulate interest in Science among children from the elementary level onward. The Municipality's representation on the Board of Directors does not exceed the 1/3 of the total members. As part of the agreement, during fiscal year 2019-2020 the Municipality contribution to C3TEC was $160,000 to cover operating expenses.

On September 24, 2013 representatives of the Municipality and of Integral Service Municipal Alliance (AMSI by Spanish acronyms) signed a one-year contract to contribute funds to cover the rent expense of AMSI for its headquarter offices located in the Municipality of Caguas. This entity was organized under the laws of Puerto Rico over 18 years ago, with the intent of providing services related to the search of employment contributing to a strengthened industry and a workforce that grows. During fiscal year 2019-2020, the Municipality contributed $100,000 to AMSI to cover rent expenses.

On July 13, 2015 representatives of the Municipality and the executive director of Youth Corporation for the Development of Sustainable Communities (CJDCS BY Spanish acronyms) signed an eight-year contract to contribute funds to cover operations expenses. CJDCS is a non-profit organization was created to have strategies and projects for the promotion of agriculture and food security in our region. During fiscal year 2019-2020, the Municipality contributed $150,000 to CJDCS to cover operations expenses.

### Housing and Rental Contracts

The Section 8 Housing Choice Voucher Program (HCVP) provides rental assistance to help very low-income families afford decent, safe, and sanitary rental housing. The Municipality as a local Public Housing Agency (PHA) is authorized under Federal and State laws to operate housing programs within an area or jurisdiction. The Municipality, as a PHA accepts the application for rental assistance, selects the applicant for admission, and issues the selected family a voucher confirming the family's eligibility for assistance. The family must then find and lease a dwelling unit suitable to the family's needs and desires in the private rental market. The PHA pays the owner a portion of the rent [a housing assistance payment (HAP)] on behalf of the family.

The subsidy provided by the HCVP is considered a tenant-based subsidy because when an assisted family moves out of a unit leased under the program, the assistance contract with the owner terminates and the family may move to another unit with continued rental assistance (24 CFR Section 982.1).

The US Department of Housing and Urban Development (HUD) enters into annual contributions contracts (ACCs) with PHAs under which HUD provides funds to the PHAs to administer the programs locally. The PHAs enter into HAP contracts with private owners who lease their units to assisted families (24 CFR Section 982.151).

During the fiscal years ended June 30, 2020 the Municipality received HAP's assistance payments in the amount of approximately $7.2 million. No significant changes are expected during the subsequent fiscal year.

continue

## 22. COMPONENTS OF FUND BALANCES

| | GENERAL FUND | CAPITAL PROJECTS FUND | DEBT SERVICE FUND | HEALTH & HUMAN SERVICES FUND | OTHER GOVERNMENTAL FUNDS | TOTAL GOVERNMENTAL FUNDS |
|---|---|---|---|---|---|---|
| **Nonexpendable** | $ - | $ - | $ - | $ - | $ - | $ - |
| **Restricted For:** | | | | | | |
| Commercial and Residential Loans | - | - | - | - | 861,864 | 861,864 |
| COVID-19 Emergency | - | - | - | 300 | 2,149,489 | 2,149,789 |
| Debt Repayments | - | - | 8,609,255 | - | - | 8,609,255 |
| Drug Prevention Programs | - | - | - | - | 12,377 | 12,377 |
| Economic Development Purposes | - | - | - | - | 302,161 | 302,161 |
| Educational Assisted Programs | - | - | - | - | 285,966 | 285,966 |
| Energy Saving Loans | - | - | - | - | 269,261 | 269,261 |
| Head Start and Elderly Programs | - | - | - | 14,505 | - | 14,505 |
| Housing Assisted Programs | - | - | - | - | 974,269 | 974,269 |
| Improvement to the City Hall Building | - | 30,285 | - | - | - | 30,285 |
| Improvements to Facilities and Buildings | 444,076 | 6,399 | - | - | 1,368 | 451,843 |
| Incubator Program | - | - | - | - | 133,163 | 133,163 |
| Infrastructure Improvements | - | 3,047,049 | - | - | 6,381 | 3,053,430 |
| Recreational Activities | - | 45,351 | - | - | 50,121 | 95,472 |
| Reforestation Initiatives | - | - | - | - | 10,140 | 10,140 |
| Safety and Security Programs | - | - | - | - | 162,135 | 162,135 |
| Social Development Purposes | - | - | - | - | 748,348 | 748,348 |
| Sureste Sport Facility Construction | - | 583,655 | - | - | - | 583,655 |
| System 911 | - | - | - | - | 6,521 | 6,521 |
| Transit Improvement Programs | 403,463 | - | - | - | 684 | 404,147 |
| **Total Restricted** | **847,539** | **3,712,739** | **8,609,255** | **14,805** | **5,974,248** | **19,158,586** |
| **Committed To:** | | | | | | |
| Economic Development Purposes | - | - | - | - | 19,403 | 19,403 |
| Transcriollo Transportation Program | - | - | - | - | 15,084 | 15,084 |
| **Total Committed** | **-** | **-** | **-** | **-** | **34,487** | **34,487** |
| **Assigned To:** | | | | | | |
| Improvements to Facilities and Buildings | - | 1,439,031 | - | - | - | 1,439,031 |
| Improvements to Facilities and Infrastructure | - | 1,844,584 | - | - | - | 1,844,584 |
| Improvements to Facilities | - | 63,403 | - | - | - | 63,403 |
| Infrastructure Improvements | - | 74,578 | - | - | - | 74,578 |
| **Total Assigned** | **-** | **3,421,596** | **-** | **-** | **-** | **3,421,596** |
| **Unassigned (Deficit)** | **(3,071,151)** | **-** | **-** | **(1,490,973)** | **(1,200,404)** | **(5,762,528)** |
| **Total Fund Balances** | **$ (2,223,612)** | **$ 7,134,335** | **$ 8,609,255** | **$ (1,476,168)** | **$ 4,808,331** | **$ 16,852,141** |

## 23. CONTINGENCIES

### Litigation

The Municipality is a defendant in legal matters that arise in the ordinary course of the Municipality's activities. With respect to pending and threatened litigation, the Municipality has reported liabilities of $129,868 in the government-wide statements for anticipated unfavorable judgments or future disbursements.

The amount presented in the total liabilities of the governmental activities in the statement of net position represents the amount estimated as probable liability, which will require future available financial resources for its payment. The Municipality's administration and legal counsel believes that the ultimate liability in excess of amounts provided would not be significant. In addition, the Municipality is a defendant or co-defendant in several legal proceedings, which are in the discovery stage. Certain of these claims are covered by insurance. Legal counsel with the information currently available cannot determine the final outcome of these claims. As a result, the accompanying general-purpose financial statements do not include adjustments, if any, that could result from the resolution of these legal proceedings.

continue

## 23. CONTINGENCIES – continuation

### Federal Financial Assistance

The Municipality receives financial assistance from the federal government in the form of grants or entitlements. The Municipality recognizes federal grant revenues when the related grant agreements are approved and notified by the federal agencies by written communication. All grants are subject to financial and compliance audits by the grantor agencies, which could result in requests for reimbursement by the grantor agencies for expenditures, if disallowed under the terms of the grants. These amounts, if any, of expenditures, which may be disallowed by the granting agencies, cannot be determined at this time. The Municipality's administration believes that such disallowances, if any, will not have a material adverse effect on the financial position of the Municipality.

## 24. TAX ABATEMENTS

The Municipality provides tax abatements through two programs— the Traditional Urban Center and Special Corridors, and new technology industries; manufacture; service; distribution (local or export); transportation; corporate headquarters, and others. Also, by Resolution 12A-55 the Court of First Instance of Puerto Rico determine the Satellite Television are exempt of Municipal Patents Law.

The Commonwealth of Puerto Rico provides tax abatements in the Municipality through eight programs— the Tax Incentives Act of 1998; Tax Incentives for the Development of Puerto Rico Act; Act to Promote the Export of Services; Green Energy Incentives Act of Puerto Rico; Tax Exemptions for Hospitals; Agricultural Tax Incentives Act of Puerto Rico; Puerto Rico Tourism Development Act of 2010; and Young Entrepreneurs Incentive and Financing Act.

Also, the Internal Revenue Code administered by the Treasury Department, provide full exemption to municipal volume of business taxes for rental of low-income families. In addition, the Puerto Rico Department of Housing administered a law that provides tax abatements in the Municipality for housing projects for elderly person with low incomes.

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continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><th rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</th><th colspan="3">Programs Administered by the Department of Economic Development of the Municipality</th></tr>
<tr><th colspan="3">Resolution 12A-55, Case DPE 2007-3979 (904) Court of First Instance of Puerto Rico</th></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">Resolution 12A-55, Case DPE 2007-3979 (904) Court of First Instance.</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Volume of Business Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">Exempt from payment of municipal patent by Satellite Television, as required by the court.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">This Act provide full exemption of Volume of Business Taxes.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>$0</td><td>$18,761</td><td>Not Applicable</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><th rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</th><th colspan="6">Programs Administered by the Department of Economic Development of the Municipality</th></tr>
<tr><th colspan="3">Ordinance No. 12A-48, Serie 2011-2012 Program</th><th colspan="3">Ordinances No. 99B-19 and 99B-58, Serie 1999-2000 Program</th></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">Review and establish new tax incentives for the jurisdiction of the Municipality and for its special zones of the Traditional Urban Center and Special Corridors.</td><td colspan="3">Promote the establishment of new technology industries; manufacture; service; distribution (local or export); transportation; corporate headquarters; communication; public utilities; farming; finance; construction and new companies dedicated to electronic commerce that are established in the Municipality, or that being an established trade or industry, make an addition or expansion in the Municipality.</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Real Property Taxes, Volume of Business Taxes, and Construction Excise Taxes.</td><td colspan="3">Real Property Taxes, Volume of Business Taxes, and Construction Excise Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act.</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">The taxpayer will contribute to maintain and improve the economic and labor stability of the industrial or commercial unit to be established, or any other factor or circumstance that reasonably demonstrates that the concession of tax incentives will result in the best socio-economic interests of the Municipality.</td><td colspan="3">The taxpayer will contribute to maintain and improve the economic and labor stability of the industrial or commercial unit to be established, or any other factor or circumstance that reasonably demonstrates that the concession of tax incentives will result in the best social and economic interests of the Municipality. The taxpayer undertakes and will perform during the first three (3) years of exemption, a permanent improvement project or service for the benefit of the community.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">Through a reduction of annual rate on Personal Property Taxes of 75% during five (5) years, or 100% during two (2) years plus 90% during the next eight (8) years, with some limitations; Real Property Taxes of 75% during five (5) years, or 40% during ten (10) years, with some limitations; Volume of Business Taxes of 75% of total amount during five (5) years, or 40% during ten (10) years, with some limitations; and full exemption on Construction Excise Taxes on new construction and expansions.</td><td colspan="3">Through a reduction of annual rate on Personal Property Taxes of 2.675%, and Real Property Taxes of 3.675% during five (5) years; Volume of Business Taxes of 50% of tax rate from three (3) to eight (8) years depending on new jobs created; and full exemption on Construction Excise Taxes on new construction and expansions.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business, total investment on construction; the approved percentage is applied to that figure to determine the abatement amounts.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business, total investment on construction; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>$1,775,827</td><td>$3,624,498</td><td>$0</td><td>$20,993</td><td>$12,359</td><td>$0</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

| *Municipality Tax Abatement Disclosure as required by GASB Statement No. 77* | **Programs Administered by the Puerto Rico Industrual Development Company** | | | | | |
|---|---|---|---|---|---|---|
| | **Tax Incentives Act of 1998 (Act Number 135 of December 2, 1997 as Amended)** | | | **Tax Incentives for the Development of Puerto Rico Act (Act Number 73 of May 28, 2008, as Amended)** | | |
| **1) Purpose of Program.** | Stimulate the formation of local capital, promote the development of the air port infrastructure and maritime, promote the export of manufactured articles in Puerto Rico, promote the development of strategic industries, promote the development of small and medium businesses, promote the establishment of regional offices and corporate headquarters and distribution centers in Puerto Rico, promote the creation of jobs and the development of human resources, and promote the development and distribution of technology in Puerto Rico. | | | Provide an adequate environment and opportunities for the continued development of our local industry; providing an attractive tax proposal that appeals to foreign direct investments and fosters the economic development and social betterment in Puerto Rico. | | |
| **2) Tax being abated.** | Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | | Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | |
| **3) Authority under which abatement agreements are entered into.** | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | |
| **4) Criteria to be eligible to receive abatement.** | Any industrial unit whose objective is the production of a manufactured product on a commercial scale; any "bonafide" industrial unit that is established on a permanent basis to produce an article designated under this law; and any service unit that has as its objective the provision on a commercial scale in Puerto Rico of some type of service designed for foreign markets, including markets in the United States. | | | Any industrial unit whose objective is the production of a manufactured product on a commercial scale; any "bonafide" industrial unit that is established on a permanent basis to produce an article designated under this law; and any service unit that has as its objective the provision on a commercial scale in Puerto Rico of some type of service designed for foreign markets, including markets in the United States. | | |
| **5) How recipients' taxes are reduced.** | Through a reduction of annual rate on Real Property Taxes and Personal Property Taxes of 90%; Volume of Business Taxes of 60% to 100% of total amount; and 60% to 100% of Construction Excite Taxes during the decrete period. | | | Through a reduction of annual rate on Real Property Taxes and Personal Property Taxes of 90% to 100% up to 15 years; Volume of Business Taxes and Construction Excise Taxes of 60% of total amount for 15 years, 100% for industries dedicated to generation of energy using renewable sources for the first 5 years and then 60% for 15 years. | | |
| **6) How amount of abatement is determined.** | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business, total investment on construction; the approved percentage is applied to that figure to determine the abatement amounts. | | | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business, total investment on construction; the approved percentage is applied to that figure to determine the abatement amounts. | | |
| **7) Provisions for recapturing abated taxes.** | N/A | | | N/A | | |
| **8) Types of commitments made by the Municipality other than to reduce taxes.** | N/A | | | N/A | | |
| **9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** |
| | **$1,932,352** | **$1,301,488** | **Not Available** | **$5,150,412** | **$1,533,444** | **Not Available** |

continue

## 24. TAX ABATEMENTS – continuation

| *Municipality Tax Abatement Disclosure as required by GASB Statement No. 77* | **Programs Administered by the Puerto Rico Industrual Development Company** | | | | | |
|---|---|---|---|---|---|---|
| | **Act to Promote The Export of Services (Act Number 20 of January 17, 2012 as Amended)** | | | **Green Energy Incentives Act of Puerto Rico (Act Number 83 of July 19, 2010 as Amended)** | | |
| **1) Purpose of Program.** | Provide provide the adequate environment and opportunities to develop Puerto Rico as an international service center, encourage local professionals to stay and return, and attract foreign capital, thus promoting the economic development and social betterment of Puerto Rico. | | | To achieve the diversification of energy sources and energy technology infrastructure by reducing our dependency on energy sources derived from fossil fuels such as petroleum; reducing and stabilizing our energy costs; controlling electricity price volatility in Puerto Rico; reducing the flight of capital caused by the import of fossil fuels; preserving and improving our environment, natural resources and quality of life; promoting the conservation of energy and social wellbeing through various mechanisms such as setting and achieving goals within a mandatory timetable, and economic and tax incentives to stimulate the generation of electric power through sustainable renewable and alternative renewable energy source. | | |
| **2) Tax being abated.** | Real and Personal Property Taxes, and Volume of Business Taxes. | | | Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | |
| **3) Authority under which abatement agreements are entered into.** | Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | |
| **4) Criteria to be eligible to receive abatement.** | Any entity with an office or bona fide establishment located in Puerto Rico which carries out or may carry out, eligible services that are, in turn, considered services for export or promoter services shall be considered an eligible business. | | | Any business engaged in the production and sale, at a commercial level, of green energy for consumption in Puerto Rico, whether as the owner and direct operator of the production unit or as owner of a production unit operated by another person, in which case, both the owner and the operator shall be deemed to be businesses engaged in an eligible activity for the purposes of this Act; Green energy producer, as defined in Section 1.4, for consumption in Puerto Rico, provided that this is his/her main business; Assembly of green energy generation equipment, including the installation of such equipment at the facilities of the green energy user to be produced by such equipment; Property engaged in the generation of green energy. | | |
| **5) How recipients' taxes are reduced.** | Through a reduction of annual rate on Real Property Taxes and Personal Property Taxes of 90% up to 20 years; and Volume of Business Taxes of 60% of total amount for 20 years. | | | Through a reduction of annual rate on Real Property Taxes and Personal Property Taxes of 90% for 25 years; Volume of Business Taxes and Construction Excise Taxes of 60% of total amount for 25 years. | | |
| **6) How amount of abatement is determined.** | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts. | | | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts. | | |
| **7) Provisions for recapturing abated taxes.** | N/A | | | N/A | | |
| **8) Types of commitments made by the Municipality other than to reduce taxes.** | N/A | | | N/A | | |
| **9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** |
| | **$25,880** | **$136,320** | **Not Available** | **$373,960** | **$73,965** | **Not Available** |

continue

## 24. TAX ABATEMENTS – continuation

| *Municipality Tax Abatement Disclosure as required by GASB Statement No. 77* | **Programs Administered by the Puerto Rico Industrual Development Company** | | | | | |
|---|---|---|---|---|---|---|
| | **Tax Exemptions for Hospitals (Act Number 168 of June 30, 1968, as Amended)** | | | **Agricultural Tax Incentives Act of Puerto Rico (Act Number 225 of December 1, 1995, as Amended)** | | |
| **1) Purpose of Program.** | To grant incentives to people dedicated to the operation of hospitals and / or homes of health in Puerto Rico and adjacent facilities; and to establish the conditions under the hospitals will enjoy said incentives, as well as to exempt from the payment of contributions bonds, promissory notes or other obligations and fifty (50) percent of the interest on the same, that these entities issue to raise the necessary funds or capital for your purposes. | | | To set the public policy in the agricultural sector and other related economic sectors; establish the requirements to qualify "bona fide" farmers and exempt them from payment of any kind of taxes on personal and real property, municipal volume of business, income, excise taxes and any municipal and/or state tax. | | |
| **2) Tax being abated.** | Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | | Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | |
| **3) Authority under which abatement agreements are entered into.** | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | |
| **4) Criteria to be eligible to receive abatement.** | Any people dedicated to the operation of hospitals and/or homes of health in Puerto Rico and adjacent facilities, shall be considered an eligible business. | | | Any natural or legal person who during the taxable year for which he claims deductions, exemptions or benefits provided by this law has a current certification issued by the Secretary of Agriculture, in consultation with the Secretary of the Treasury, which certifies that during said year was dedicated to the exploitation of an activity that qualifies as an agricultural business, as said term is defined in subsection (b) of this section, and which derives fifty percent (50%) or more of its gross income from a agricultural business as operator, owner or lessee, as recorded in yourtheir income tax return, shall be considered an eligible business. | | |
| **5) How recipients' taxes are reduced.** | This Act, as amended, provide full exemption of Real Property Taxes and Personal Property Taxes; Volume of Business Taxes and Construction Excise Taxes. | | | This Act, as amended, provide full exemption of Real Property Taxes and Personal Property Taxes; Volume of Business Taxes and Construction Excise Taxes. | | |
| **6) How amount of abatement is determined.** | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts. | | | The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts. | | |
| **7) Provisions for recapturing abated taxes.** | N/A | | | N/A | | |
| **8) Types of commitments made by the Municipality other than to reduce taxes.** | N/A | | | N/A | | |
| **9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** |
| | **$2,144,992** | **$955,651** | **Not Available** | **$16,523** | **$7,759** | **Not Available** |

continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><th rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</th><th colspan="6">Programs Administered by the Puerto Rico Industrual Development Company</th></tr>
<tr><th colspan="3">Foreign Trade Zones (Act Number 131 of June 17, 1999)</th><th colspan="3">Young Entrepreneurs Incentive and Financing Act (Act Number 135 of August 7, 2014, as Amended)</th></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">To promote the export activity generated by companies located in a Foreign Trade Zone, including the income generated by the products used in the process of manufacturing, mixing or packaging made within the area, established in accordance with the provisions of the Zone Act of Foreign Trade of 1934 (19 USC 81C (a)), by an entity incorporated under the laws of the Government of Puerto Rico or by a company authorized to do business in Puerto Rico.</td><td colspan="3">To promote the retention of Puerto Rican talent and foster the return of young professionals who have left the Island.</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Personal Property Taxes and Volume of Business Taxes.</td><td colspan="3">Personal Property Taxes and Volume of Business Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act.</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">It grants an exemption from the payment of personal property taxes and municipal patents exclusively to the merchandized and the volume of business derived from the export of those companies whose operations are in the Foreign Trade Zones.</td><td colspan="3">This Act offers various competitive advantages for young professionals to work and establish themselves in Puerto Rico. Firstly, full income tax exemption is provided for the first forty thousand dollars ($40,000) earned by young persons between the ages of sixteen (16) and (26) on account of wages, rendered services, or self-employment, shall be considered an eligible business.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">Through a reduction of annual rate on Personal Property Taxes of 100%; and Volume of Business Taxes of 100%.</td><td colspan="3">This Act provide full exemption of Personal Property Taxes and Volume of Business Taxes for the first $500,000 of volume earned for a period of 3 years.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value and volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>$712,567</td><td>$7,120</td><td>Not Applicable</td><td>Not Available</td><td>$10,392</td><td>Not Available</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><th rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</th><th colspan="3">Programs Administered by the Puerto Rico Industrual Development Company</th></tr>
<tr><th colspan="3">Puerto Rico Tourism Development Act of 2010 (Act Number 74 of July 10, 2010, as Amended)</th></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">To set the public policy to make Puerto Rico a world-class</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act.</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">Any hotels, condo hotels, Puerto Rican hostels, agro-housing, guest houses, timeshare rights plans and vacation clubs, hostels that belong to the "Posadas de Puerto Rico" program, those certified as "Bed and Breakfast (B & B)" and any other from time to time are part of programs promoted by the Tourism Company, theme parks, golf courses operated by, or associated with, a hotel that is an exempt business under this Act, the Tourism Development Act of Puerto Rico of 1993 or any another similar law of an analogous nature, or golf courses included within a destination or tourist complex (resort), tourist marinas, facilities in port areas for tourism purposes, agrotourism, nautical tourism (provided, however, that any marina in the Islands Municipalities of Vieques and Culebra will be considered as tourist marine for purposes of this Law), medical tourism and other facilities or activities that, due to the special attraction derived from its usefulness as a source of active, passive or fun entertainment, shall be considered an eligible business.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">Through a reduction of annual rate on Real Property Taxes and Personal Property Taxes of 90% for 10 years; Volume of Business Taxes of 100% to new business for 10 years, and existing business of 90% for 10 years; and Construction Excise Taxes of 100% of total amount of new construction for 10 years.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>$616,116</td><td>$118,446</td><td>Not Available</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><th rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</th><th colspan="6">Programs Administered by the Puerto Rico Treasury Department</th></tr>
<tr><th colspan="3">Law on Cooperative Savings and Credit Societies (Act Number 225 of October 28, 2002)</th><th colspan="3">Section 1101 (a) (6) of Internal Revenue Code of Puerto Rico</th></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">To facilitate and advance the growth and strengthening of savings and credit cooperatives organized under this Act, to encourage broad and full participation in the financial services markets and to promote the expansion of the</td><td colspan="3">Promote non-profit organization.</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Real and Personal Property Taxes, Volume of Business Taxes, and Construction Excise Taxes.</td><td colspan="3">Volume of Business Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law.</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">"Cooperative" means any cooperative savings and credit cooperative of first or second degree constituted and organized in accordance with this Act. Those cooperatives whose partners are cooperative entities shall be considered as second degree cooperatives. "Closed cooperatives" means any first-tier savings and credit cooperative whose members are limited to a particular company or group to the exclusion of other groups. "Insured Cooperative" means any cooperative that receives the stock and deposit insurance that the Corporation will provide. "Adequate Condition Cooperative" means that credit and savings cooperative that has an adequate financial and managerial condition, to be</td><td colspan="3">The taxpayer will be a non-profit organization to be eligible.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">This Act, as amended, provide full exemption of Real Property Taxes and Personal Property Taxes; Volume of Business Taxes and Construction Excise Taxes.</td><td colspan="3">This Act provide full exemption of Volume of Business Taxes.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable property value, volume of business, total investment on construction; the approved percentage is applied to that figure to determine the</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>$493,357</td><td>$17,643</td><td>Not Applicable</td><td>$2,613</td><td>$64,987</td><td>Not Applicable</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

<table>
<tr><td rowspan="2">Municipality Tax Abatement Disclosure as required by GASB Statement No. 77</td><td colspan="3">Programs Administered by the Puerto Rico Department of Treasury</td></tr>
<tr><td colspan="3">Section 1101 (a) (6) of Internal Revenue Code of Puerto Rico</td></tr>
<tr><td>1) Purpose of Program.</td><td colspan="3">Promote low-income families access to rental housing at reasonable prices.</td></tr>
<tr><td>2) Tax being abated.</td><td colspan="3">Volume of Business Taxes.</td></tr>
<tr><td>3) Authority under which abatement agreements are entered into.</td><td colspan="3">Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law.</td></tr>
<tr><td>4) Criteria to be eligible to receive abatement.</td><td colspan="3">The taxpayer will be a low-income family to be eligible.</td></tr>
<tr><td>5) How recipients' taxes are reduced.</td><td colspan="3">This Act provide full exemption of Volume of Business Taxes.</td></tr>
<tr><td>6) How amount of abatement is determined.</td><td colspan="3">The amount of the direct reduction to revenues is based on the calculated certified reasonable volume of business; the approved percentage is applied to that figure to determine the abatement amounts.</td></tr>
<tr><td>7) Provisions for recapturing abated taxes.</td><td colspan="3">N/A</td></tr>
<tr><td>8) Types of commitments made by the Municipality other than to reduce taxes.</td><td colspan="3">N/A</td></tr>
<tr><td rowspan="2">9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.</td><td>Property Taxes</td><td>Volume of Business Taxes</td><td>Construction Excite Taxes</td></tr>
<tr><td>Not Applicable</td><td>$14,082</td><td>Not Applicable</td></tr>
</table>

continue

## 24. TAX ABATEMENTS – continuation

| *Municipality Tax Abatement Disclosure as required by GASB Statement No. 77* | **Programs Administered by the Puerto Rico Department of Housing** | | |
|---|---|---|---|
| | **Act Number 165 of August 23, 1996** | | |
| **1) Purpose of Program.** | Housing Rental Program for the Elderly with Low Income properties. | | |
| **2) Tax being abated.** | Real Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | |
| **3) Authority under which abatement agreements are entered into.** | Law Number 81 of August 30, 1991, as amended, known as the Autonomous Municipalities Act of the Commonwealth of Puerto Rico; Law Number 113 of July 10, 1974, as amended by Law Number 82 of August 30, 1991, known as the Municipal Patents Law; and Law Number 83 of August 30, 1991, as amended, known as the Municipal Property Tax Act. | | |
| **4) Criteria to be eligible to receive abatement.** | The taxpayer will rent residential property to elderly with low-income to be eligible. | | |
| **5) How recipients' taxes are reduced.** | This Act provide 90% exemption of Real Property Taxes, Volume of Business Taxes, and Construction Excise Taxes. | | |
| **6) How amount of abatement is determined.** | The amount of the direct reduction to revenues is based on the calculated certified reasonable volume of business; the approved percentage is applied to that figure to determine the abatement amounts. | | |
| **7) Provisions for recapturing abated taxes.** | N/A | | |
| **8) Types of commitments made by the Municipality other than to reduce taxes.** | N/A | | |
| **9) Gross dollar amount, on accrual basis, by which the Municipality's tax revenues were reduced as a result of abatement agreement.** | **Property Taxes** | **Volume of Business Taxes** | **Construction Excite Taxes** |
| | **$553,109** | **$6,697** | **Not Applicable** |

On July 1, 2019, the Commonwealth of Puerto Rico approved the new Puerto Rico Incentive Code, to consolidate the dozens of existing decrees, incentives, subsidies, reimbursements, or tax or financial benefits; promote the environment, the opportunities and the adequate tools to promote the sustainable economic development of Puerto Rico; establish the legal and administrative framework that will govern the request, evaluation, concession or denial of incentives by the Commonwealth of Puerto Rico; promote the effective and continuous measurement of the costs and benefits of the incentives that are granted to maximize the impact of the investment of public funds; give stability, certainty and credibility to the Commonwealth of Puerto Rico in everything related to private investment; and improve Puerto Rico's economic competitiveness.

continue

## 25. NET POSITION / FUND BALANCES RESTATEMENT

For the year ended June 30, 2020, the Municipality adjusted net position and fund balance of General Fund, to reflect prior period adjustment related to a repayment plan with the Retirement System Adminstration.

The following schedule reconciles the June 30, 2019 Net Position and Fund Balance, respectively, as previously reported to Beginning Net Position and Fund Balance, respectively, as restated, July 1, 2019:

| | | GOVERNMENTAL ACTIVITIES |
|---|---|---|
| Net Position, as Previously Reported, At June 30, 2019 | $ | 19,185,162 |
| Adjustment to Net OPEB Liability | | (8,087,089) |
| Adjustment to Net Pension Liability | | (5,515,908) |
| Adjustment to Retirement System Administration Debt | | 197,500 |
| **Beginning Net Position, as Restated, At July 1, 2019** | **$** | **5,779,665** |

| | | GENERAL FUND |
|---|---|---|
| At June 30, 2019 | $ | (8,557,734) |
| Adjustment to Retirement System Administration Debt | | 1,975,000 |
| **Beginning Fund Balance, As Restated, At July 1, 2019** | **$** | **(6,582,734)** |

## 26. GOING CONCERN – COMMONWEALTH OF PUERTO RICO

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

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

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

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

continue

**26. GOING CONCERN – COMMONWEALTH OF PUERTO RICO** – continuation

| | 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.

As part of the original Fiscal Plan approved by the Oversight Board on March 13, 2017 presented by the Governor of Puerto Rico to attend the fiscal crisis, contemplates a reduction of $350.0 million of subsidies to the municipalities of Puerto Rico. Already in FY 2018, the total municipal appropriation was reduced by $150 million, bringing the new baseline appropriations to $220 million per year. Going forward from this baseline, with the New Fiscal Plan approved by the Oversight Board on April 19, 2018, there must be a reduction of 20% in each successive year, holding appropriations constant at 80% of current levels starting in FY 2022 before ultimately phasing out all subsidies in FY 2024. A new Fiscal Plan was approved by the Oversight Board on May 9, 2019 (see Note 27 for more details).

***PUERTO RICO FILES FOR BANKRUPTCY UNDER PROMESA TITLE III***

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

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

continue

## 26. GOING CONCERN – COMMONWEALTH OF PUERTO RICO – continuation

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

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

- Although that is a critical dispute.

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

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

*Remediation Plan*

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

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

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

On September 27, 2019, the Oversight Board filed a proposed plan of adjustment of Commonwealth debt that would reduce most of the Commonwealth's debt obligations by approximately 70% and establishes a roadmap to exit bankruptcy. As of the date of these basic financial statements, the disclosure statement accompanying the proposed plan of adjustment has not yet been approved by the Title III Court (postponed consideration up to June 2021) 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.

The **Municipality** has made adjustments to their finances and have been working in eliminating the accumulated deficit in the General Fund. It is our conclusion, that the **Municipality**, although is a covered entity under PROMESA, has a low risk of going concern.

continue

## 27. 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.

***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.

continue

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

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.

*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;

continue

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

3. Provide adequate funding for public pension systems;
4. Provide for the elimination of structural deficits;
5. For fiscal years in which a stay is not effective, provide for a debt burden that is sustainable;
6. Improve fiscal governance, accountability, and internal controls;
7. Enable the achievement of fiscal targets;
8. Create independent forecasts of revenue for the period covered by the fiscal plan;
9. Include a debt sustainability analysis;
10. Provide for capital expenditures and investments necessary to promote economic growth;
11. Adopt appropriate recommendations submitted by the Oversight Board;
12. Include such additional information as the Oversight Board deems necessary;
13. Ensure that assets, funds, or resources of a territorial instrumentality are not loaned to, transferred to, or otherwise used for the benefit of a covered territory or another covered territorial instrumentality of a covered territory, unless permitted; and
14. Respect the relative lawful priorities or lawful liens in the constitution, other laws, or agreements of a covered territory or covered territorial instrumentality in effect prior to the enactment of PROMESA.

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

- **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.

continue

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

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

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

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

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

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

**Fiscal Plan – 2019**

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

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

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

continue

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

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

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

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

**Fiscal Plan – 2020**

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

continue

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

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.

***Restoring Growth to the Island***

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

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

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

***Human Capital & Welfare Reform (Chapter 8)***

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

continue

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

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

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

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

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

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

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

continue

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

### *K-12 Education Reform (Chapter 9)*

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

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

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

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

### Investing in Student Outcomes

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

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

continue

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

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

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

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

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

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

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

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

continue

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

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

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

***Ease of Doing Business Reform (Chapter 10)***

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

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

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

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

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

continue

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

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

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

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

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

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

***Power Sector Reform (Chapter 11)***

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

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

continue

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

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

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

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

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

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

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

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

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

continue

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

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

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

***Infrastructure Reform (Chapter 12)***

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

**Current state of Infrastructure and Capital Investment**

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

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

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

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

continue

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

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

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

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

**Transforming Government to Better Serve the Island**

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

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

***Agency Efficiencies (Chapter 13)***

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

continue

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

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

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

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

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

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

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

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

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

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

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

continue

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

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

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

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

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

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

continue

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

***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. 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

continue

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

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

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

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

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

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

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

continue

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

- **Strengthening oversight of Special Revenue Funds (SRF) through enhanced control mechanisms to:**

  – Implement processes that improve stewardship of all SRF

  – Ensure all revenue streams attributable to SRF are deposited within the TSA

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

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

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

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

  – 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)

continue

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

- **Overseeing the Implementation of the Certified Fiscal Plan to:**
  - Enable all Government agencies to comply with efficiency measures stipulated within the Certified Fiscal Plan
  - Facilitate timely and targeted interventions to address areas of underperformance relative to efficiency measures

***Medicaid Investments and Reform (Chapter 15)***

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

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

Because federal Medicaid funding for US territories is subject to an annual cap, Medicaid expenditures eligible for federal matching exceed available funding without supplemental legislated sources. This makes Puerto Rico's Medicaid program very sensitive to rising healthcare costs. Since 2011, Puerto Rico has received temporary relief from rising healthcare costs through increased levels of federal reimbursement made available through the passage of the Affordable Care Act and the Bipartisan Budget Act of 2018. In December 2019, the Further Consolidated Appropriations Act was passed, which provided supplemental federal funding (up to $5.7B total) to Puerto Rico's Medicaid program through September 30, 2021 (first quarter in FY2022). In addition, the law raised the FMAP—the portion of Medicaid expenditures that federal funds can cover—from the standard level of 55% to 76% for most populations. In response to the COVID-19 pandemic, the Families First Coronavirus Response Act was passed in March 2020, further increasing both the available federal funds (adding an additional $183M) and the FMAP (increased an additional 6.2% for most populations). The available supplemental federal funds and higher FMAP will both return to standard levels in October 2021 without new federal legislation. Accordingly, the Commonwealth will hit a "Medicaid fiscal cliff," whereby it will be responsible for multi-billion-dollar annual healthcare expenditures that had been covered by federal funding since 2011. It is crucial, therefore, that ASES take advantage of the additional runway provided by recent federal legislation to put in place reforms that reduce the long-term growth rate of healthcare expenditures. Given the uncertainty as to future federal reimbursement levels, the 2020 Fiscal Plan assumes that no further supplemental funding will be provided beyond current programs, and thus, the Commonwealth must be prepared to cover growing Medicaid costs as if federal reimbursement rates revert to steady-state levels.

continue

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

***Tax Compliance and Fees Enhancement (Chapter 16)***

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

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

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

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

**Improve Compliance Rate**

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

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

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

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

continue

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

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

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

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

**Right-rate Other Taxes and Fees**

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

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.

continue

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

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

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

***Reduction in Appropriations to UPR (Chapter 17)***

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

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

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

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

continue

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

### *Municipal Service Reform (Chapter 18)*

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

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

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

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

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

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.

continue

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

### Act No. 29-2019

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

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

### Accelerating Post-Disaster Recovery at Municipalities

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

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.

continue

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

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

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

### COVID-19 Crisis

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

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

### Liquidity Facility

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

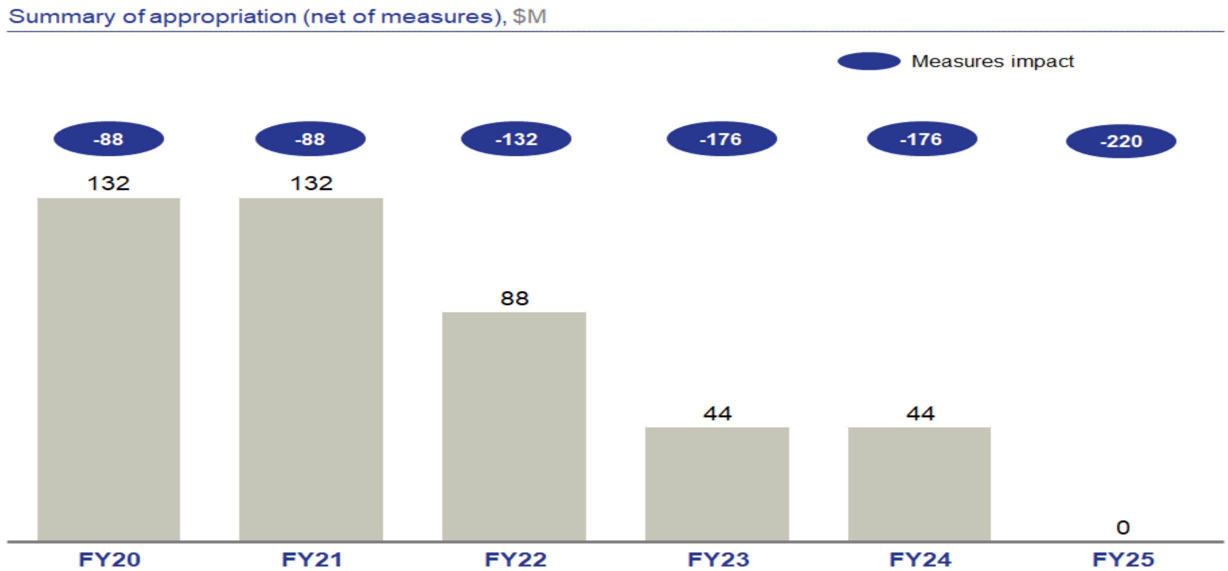
### Incentivizing Consolidation of Services

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.

continue

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

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




### Oversight Board's Municipalities Pilot Program

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

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

### *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

## 27. 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 No. 106-2017

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

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

### 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

## 27. 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

## 27. 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.
- **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

continue

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

- **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).

## 28. SUBSEQUENT EVENTS

In May 4, 2021, got approved a Non-Revolving Line of Credit in the aggregate principal amount of $19,206,060 (the "NRLOC") by the Oversight Board, the Debt Transaction consists of the request by the Municipality (i) to be granted from commercial bank to advance funds over an 18-month draw period for eligible projects to remedy the damage suffered as a result of Hurricane María, which are eligible for reimbursement from the Federal Emergency Management Agency ("FEMA"), and (ii) obtain a 7-year amortizing term loan (the "Note") to convert any unpaid, outstanding balance on the NRLOC after draw period ends.

The Note is structured to fully amortize over a fifteen (15) year term with monthly interest-only payments during the draw period followed by non-equal annual principal and interest payments and a balloon payment made at maturity after the seven (7) year Note. The NRLOC and Note will accrue interest at a variable rate equal to the sum of the Prime Rate plus an applicable margin of 0.50% (currently 3.75%) with a minimum interest rate floor of 3.75%. In connection with the proposed transaction, the Municipality will pay a $35,000 Commitment Fee, $45,000 legal expenses, and $68,545 fiscal agent fees.

continue

**28. SUBSEQUENT EVENTS – continuation**

In May 2021, the Municipality was awarded with $67 million from the Coronavirus State and Local Fiscal Recovery Funds provided by the American Rescue Plan Act (ARPA) of 2021. The Coronavirus State and Local Fiscal Recovery Funds provide a substantial infusion of resources to help turn the tide on the pandemic, address its economic fallout, and lay the foundation for a strong and equitable recovery.

FUNDING OBJECTIVES

The Federal Treasury is launching this much-needed relief to:

- Support urgent COVID-19 response efforts to continue to decrease spread of the virus and bring the pandemic under control
- Replace lost revenue for eligible state, local, territorial, and Tribal governments to strengthen support for vital public services and help retain jobs
- Support immediate economic stabilization for households and businesses
- Address systemic public health and economic challenges that have contributed to the inequal impact of the pandemic

The Coronavirus State and Local Fiscal Recovery Funds provide substantial flexibility for each government to meet local needs—including support for households, small businesses, impacted industries, essential workers, and the communities hardest hit by the crisis. These funds can also be used to make necessary investments in water, sewer, and broadband infrastructure.

During fiscal year 2021, the Municipality got awarded $15 million from the Community Development Block Grant-Disaster Recovery funds program from the Department of Housing and Urban development for the Municipality's land and infrastructure improvements for damage that came from the Huracan Maria.

Also, the Municipality got approved a 10% matching from Municipality's funds from the Federal Emergency Management Agency (FEMA) for the improvements from the damages that came from Hurricane Maria. FEMA funds will be use on improvements of Caguas city's road and streets, public buildings and parks and recreational facilities.

On March 19, 2021, the OMB issued the M-21-20, stated that: :" Awarding agencies, in their capacity as cognizant or oversight agencies for audit, should allow recipients and subrecipients that have not yet filed their single audits with the Federal Audit Clearinghouse as of the date of the issuance of this memorandum that have fiscal year-ends through June 30, 2021, to delay the completion and submission of the Single Audit reporting package, as required under Subpart F of 2 CFR §200.501 to six months beyond the normal due date. No further action by awarding agencies is required to enact this extension. This extension does not require individual recipients and subrecipients to seek approval for the extension by the cognizant or oversight agency for audit; however, recipients and subrecipients should maintain documentation of the reason for the delayed filing. Recipients and subrecipients taking advantage of this extension would still qualify as a "low-risk auditee" under the criteria of 2 CFR § 200.520(a). (2 CFR § 200.501)".

In preparing these financial statements, the Municipality has evaluated significant transactions for potential recognition or disclosure through May 27, 2021, the date the financial statements were issued. Based on such analysis, no additional transaction needs to be recorded or disclosed.

**END OF NOTES**

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# Required Supplementary Information

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| | Budget Amounts | | Actual Amounts (Budgetary Basis) | Variance with |
|---|---|---|---|---|
| | Original | Final | (See Notes 1 and 2) | Final Budget |
| Resources (Inflows): | | | | |
| Property Taxes | $ 27,219,295 | $ 28,414,776 | $ 27,285,613 | $ (1,129,163) |
| Volume of Business Taxes | 22,675,000 | 23,378,544 | 25,951,557 | 2,573,013 |
| Sales and Usage Taxes | 17,000,000 | 19,358,199 | 18,399,369 | (958,830) |
| Construction Excise Taxes | 7,415,000 | 7,415,000 | 3,094,772 | (4,320,228) |
| Intergovernmental Revenues | 5,825,542 | 5,825,542 | 7,543,764 | 1,718,222 |
| Interest | 110,000 | 110,000 | 176,327 | 66,327 |
| Rent and Other Resources | 1,707,645 | 1,707,645 | 1,224,133 | (483,512) |
| Fines and Penalties | 600,000 | 600,000 | 811,857 | 211,857 |
| **Total Resources (Inflows)** | 82,552,482 | 86,809,706 | 84,487,392 | (2,322,314) |
| Charges to Appropriations (Outflows): | | | | |
| General Government | 39,276,563 | 41,494,031 | 41,454,550 | 39,481 |
| Public Safety | 7,481,526 | 6,855,564 | 5,033,113 | 1,822,451 |
| Public Works | 8,710,339 | 12,353,387 | 11,602,949 | 750,438 |
| Culture and Recreation | 4,119,970 | 4,030,945 | 3,804,310 | 226,635 |
| Health and Welfare | 1,885,373 | 1,846,229 | 1,779,862 | 66,367 |
| Economic and Social Development | 3,499,127 | 3,310,519 | 3,055,156 | 255,363 |
| Housing | 840,023 | 819,397 | 701,727 | 117,670 |
| Sanitation and Environmental | 15,047,189 | 14,429,435 | 12,609,459 | 1,819,976 |
| Education | 1,692,372 | 1,670,199 | 1,607,380 | 62,819 |
| Total Charges to Appropriations | 82,552,482 | 86,809,706 | 81,648,506 | 5,161,200 |
| **Excess of Appropriations Over Resources** | **$ -** | **$ -** | **$ 2,838,886** | **$ 2,838,886** |

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 fund.

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

| | General Fund |
|---|---|
| **Sources/Inflows of Resources:** | |
| Actual Amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule (See Page 162) | $ 84,487,392 |
| Basis of accounting: | |
| Net change in assets and deferred inflow of resources | (404,575) |
| Perspective Difference: | |
| Non Budgetary items - Revenues of Other Funds | 4,953,951 |
| Total Revenues as Reported on the Statement of Revenues, Expenditures and Changes in Fund Balance (See Page 28) | $ 89,036,768 |
| **Uses/Outflows of Resources:** | |
| Actual Amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule (See Page 162) | $ 81,648,506 |
| Difference – Budget to GAAP: | |
| Perspective Difference: | |
| Non Budgetary items - Expenditures of Other Funds | 11,405,328 |
| Other Items - Non budgetary | 50,721 |
| Timing Difference: | |
| Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for budgetary reporting purposes | (4,410,559) |
| Payments of encumbrances of prior year that are expenditures for financial reporting purposes but are not outflows for budgetary purposes | 1,575,080 |
| Transfers to Other Funds are outflows of budgetary resources but are not expenditures for financial reporting purposes | (11,420,198) |
| Total Expenditures as Reported on the Statement of Revenues, Expenditures and Changes in Fund Balance (See Page 28) | $ 78,848,878 |

**END OF NOTES**

# SCHEDULE OF PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
## FOR THE FISCAL YEAR ENDED JUNE 30, 2020

| | 2015 | 2016 | 2017 | 2018 |
|---|---|---|---|---|
| Proportion of the Net Pension Liability ** | 0.60206% | 0.61548% | 0.62621% | 0.63153% |
| Proportionate Share of the Net Pension Liability | $ 181,452,720 | $ 205,183,593 | $ 236,074,839 | $ 216,098,495 |
| Covered - Employee Payroll | $ 21,006,307 | $ 20,429,505 | $ 20,942,983 | $ 21,119,669 |
| Proportionate Share of the Net Pension Liability as Percentage of Covered-Employee Payroll | 863.80% | 1004.35% | 1127.23% | 1023.21% |
| Plan's Fiduciary Net Position | $ 485,654 | $ (4,113,081) | $ (7,927,147) | $ (13,318,078) |
| Plan Fiduciary Net Position as a 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. Beginning July 1, 2017 the pension benefits was paid through pay-as-you-go method.

**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 only threee years are shown.
The first measurement date used was 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 |
|---|---|---|---|---|
| Contractually Required Contribution (Actuarially Determined) | $ 4,520,621 | $ 4,719,716 | $ 4,988,182 | $ 4,412,705 |
| Contributions in Relation to the Actuarially Required Contributions | 4,520,621 | 4,719,716 | 4,988,182 | 4,412,705 |
| Contribution Deficiency (Excess) | $ - | $ - | $ - | $ - |
| Covered - Employee Payroll | $ 21,006,307 | $ 20,429,505 | $ 20,942,983 | $ 21,119,669 |
| Contributions as a Percentage of Covered-Employee Payroll | 21.52% | 23.10% | 23.82% | 20.89% |

**Methods and Assumptions Used in Calculation of the ERS'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 | |
| 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.<br><br>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<br><br>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 Municipality implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, during fiscal year 2015, and these schedules are now required.

2. This information is intended to help users assess the Municipality'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 Municipality and not Employee's Retirement System of the Government of the Commonwealth of Puerto Rico as a whole.

**END OF NOTES**

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# Supplementary Information Required by U.S. Department of Housing and Urban Development

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| Line Ited No. Assets | | Value |
|---|---|---|
| | **Current Assets - Cash:** | |
| 111 | Cash - Unrestricted | $ 1,042,657 |
| 113 | Cash - Other Restricted | 315,880 |
| 115 | Cash - Restricted for Payment of Current Liabilities | 1,609 |
| **100** | **Total Cash** | **1,360,146** |
| | **Receivables:** | |
| 121 | Accounts Receivable - PHA Projects | 50,946 |
| 128 | Fraud Recovery | 24,256 |
| 128.1 | Allowance for Doubtful Accounts - Fraud Recovery | (24,256) |
| **120** | **Total Receivables, Net of Allowancesfor Doubtful Accounts** | **50,946** |
| **150** | **Total Current Assets** | **1,411,092** |
| | **Fixed Assets:** | |
| 164 | Furniture, Equipment & Machinery - Administration | 544,491 |
| 166 | Accumulated Depreciation | (479,025) |
| **160** | **Total Capital Assets, Net of Accumulated Depreciation** | **65,466** |
| **190** | **Total Assets** | **1,476,558** |
| 200 | Deferred Outflow of Resources | - |
| **290** | **Total Assets and Deferred Outflow of Resources** | **$ 1,476,558** |

continue

| Liabilities and Equity | | |
|---|---|---|
| | **Liabilities:** | |
| | **Current Liabilities:** | |
| 312 | Accounts Payable <=90 days | $ 30,276 |
| 322 | Accrued Compensated Absences - Current Portion | 55,600 |
| 331 | Accounts Payable - HUD PHA Programs | 1,609 |
| 332 | Accounts Payable - PHA Projects | 43,794 |
| 333 | Accounts Payable - Other Government | 189,341 |
| 342 | Unearned Revenues | 181,900 |
| **310** | **Total Current Liabilities** | **502,520** |
| | **Non-current Liabilities:** | |
| 354 | Accrued Compensated Absences - Non-Current | 131,147 |
| **350** | **Total Non-Current Liabilities** | **131,147** |
| **300** | **Total Liabilities** | **633,667** |
| 400 | Deferred Inflow of Resources | - |
| | **Equity:** | |
| 508.4 | Net Investment in Capital Assets | 65,466 |
| 511.4 | Restricted Net Position | 90,186 |
| 512.4 | Unrestricted Net Position | 687,149 |
| **513** | **Total Equity / Net Position** | **842,801** |
| **600** | **Total Liabilities, Deferred Inflow of Resourses and Equity / Net Position** | **$ 1,476,468** |

See accompanying notes to Financial Data Schedule.

| Line Ited No. | | Value |
|---|---|---|
| **Revenues** | | |
| 70600 | HUD PHA Operating Grants | $ 8,147,130 |
| 71100 | Investment Income - Unrestricted | 5,977 |
| 71400 | Fraud Recovery | 34,782 |
| 71500 | Other Revenue | 343,807 |
| **70000** | **Total Revenues** | **8,531,696** |
| **Expenses** | | |
| | **Administrative:** | |
| 91100 | Administrative Salaries | 476,777 |
| 91200 | Auditing Fees | 11,000 |
| 91500 | Employee Benefit Contributions - Administrative | 92,067 |
| 91600 | Office Expenses | 220,100 |
| 91800 | Travel | 184 |
| 91900 | Other | 47,825 |
| **91000** | **Total Operating - Administrative** | **847,953** |
| | **General Expenses:** | |
| 96600 | Bad Debts - Other | - |
| **96000** | **Total Operating - General Expenses** | **-** |
| **96900** | **Total Operating Expenses** | **847,953** |
| **97000** | **Excess of Operating Revenue over Operating Expenses** | **7,683,743** |
| 97300 | Housing Assitance Payments | 7,246,155 |
| 97350 | HAP Portability-In | 321,141 |
| 97400 | Depreciation Expense | 34,875 |
| **90000** | **Total Expenses** | **8,450,124** |
| **10000** | **Excess (Deficiency) of Total Revenue over (under) Total Expenses** | **$ 81,572** |
| | **Memo Account Information:** | |
| *11030 | Beginning Equity | $ 761,229 |
| *11170 | Administrative Fee Equity | $ 752,615 |
| *11180 | Housing Assistance Payments Equity | $ 90,186 |
| *11190 | Unit Months Available | 15,900 |
| *11210 | Number of Unit Months Leased | 15,404 |

See accompanying notes to Financial Data Schedule.

## 1. GENERAL

The accompanying Financial Data Schedules (FDS) includes the Section 8 Housing Choice Vouchers Program activities of the Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico (Municipality). The information in the FDS is presented in accordance with the requirements of *HUD's Uniform Financial Reporting Standards for HUD Housing Programs.* Because the FDS presents only a selected portion of the operations of Municipality, it is not intended to and does not present the financial position, or change in net position of the Municipality.

Therefore, some amounts presented in this Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements. The Municipality reporting entity is defined in Note (1) (A) to the basic financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Assets, Liabilities, Net Assets, Revenues and Expenses reported on the FDS, are reported on the full accrual basis of accounting. They are recognized following the *HUD's Uniform Financial Reporting Standards for HUD Housing Programs.*

## 3. RELATIONSHIP TO BASIC FINANCIAL STATEMENTS

Assets, Liabilities and Net Assets/Position are presented in the Municipality's *Statement of Net Position*. Revenues and Expenses are reported in the *Statement of Activities*.

**END OF NOTES**

# PART II

# SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS AND REPORTS REQUIRED BY GOVERNMENT AUDITING STANDARDS AND UNIFORM GUIDANCE

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| *Federal Grantor/Pass-Through Grantor/Program or Cluster Title* | *Federal CFDA Number* | *Pass-Through Entity Identifying Number* | *Passed Through to Subrecipients* | *Total Federal Expenditures* |
|---|---|---|---|---|
| U.S. Department of Agriculture Program: | | | | |
| Pass-Through the Puerto Rico Department of Education: | | | | |
| Child and Adult Care Food Program | 10.558 | CCC-003 | $ - | $ 1,053,654 |
| *Total U.S. Department of Agriculture Program* | | | - | 1,053,654 |
| U.S. Department of Housing and Urban Development Programs: | | | | |
| Community Development Block Grants/Entitlements Grants | 14.218 | | - | 1,663,726 |
| COVID-19 - Community Development Block Grants/Entitlements Grants | 14.218 | | - | 423,106 |
| Total Community Development Block Grants/Entitlements Grants | | | - | 2,086,832 |
| Emergency Solutions Grant Program | 14.231 | | 78,389 | 127,283 |
| Home Investment Partnership Program (HOME) | 14.239 | | - | 1,014,850 |
| Continuum of Care Program | 14.267 | | - | 257,047 |
| Section 8 Housing Choice Vouchers Program | 14.871 | | - | 8,417,455 |
| *Total U.S. Department of Housing and Urban Development Programs* | | | 78,389 | 11,903,467 |
| U.S. Department of Justice Programs: | | | | |
| Public Safety Partnership and Community Policing Grant | 16.710 | | - | 116,849 |
| Pass-Through the Puerto Rico Department of Justice: | | | | |
| Crime Victim Assistance | 16.575 | 2018-V2-CAGUA-01 | - | 182,322 |
| *Total U.S. Department of Justice Programs* | | | - | 299,171 |
| U.S. Department of Transportation Programs: | | | | |
| Federal Transit Cluster Programs: | | | | |
| Federal Transit Formula Grants (Urbanized Area Formula Program) | 20.507 | | - | 113,265 |
| Buses and Bus Facilities Formula, Competitive, and Low or No Emissions Programs | 20.526 | | - | 343,009 |
| Total Federal Transit Cluster Programs | | | - | 456,274 |
| Pass-Through the Puerto Rico Traffic Safety Commission: | | | | |
| State and Community Highway Safety | 20.600 | 20-05-54 | - | 13,666 |
| *Total U.S. Department of Transportation Programs* | | | - | 469,940 |

continue

| *Federal Grantor/Pass-Through Grantor/Program or Cluster Title* | *Federal CFDA Number* | *Pass-Through Entity Identifying Number* | *Passed Through to Subrecipients* | *Total Federal Expenditures* |
|---|---|---|---|---|
| U.S. The Department of the Treasury: | | | | |
| Pass-Through the Puerto Rico Fiscal Agency and Financial Advisory Authority (FAFAA): | | | | |
| Coronavirus Relief Fund | 21.019 | | $ - | $ 2,031,811 |
| *Total U.S. The Department of the Treasury* | | | - | 2,031,811 |
| U.S. Environmental Protection Agency Program: | | | | |
| Pass-Through the Puerto Rico Environmental Quality Board: | | | | |
| Capitalization Grants for Clean Water State Revolving Funds | 66.458 | C-72-082-08 | - | 177,108 |
| *Total U.S. Environmental Protection Agency Program* | | | - | 177,108 |
| U.S. Department of Education Programs: | | | | |
| Pass-Through the Puerto Rico Department of Education: | | | | |
| Adult Education – Basic Grants to States | 84.002 | A000710 | - | 633 |
| Twenty-First Century Community Learning Centers | 84.287 | 2020-AF0042 | - | 391,502 |
| *Total U.S. Department of Education Programs* | | | - | 392,135 |
| U.S. Department of Health and Human Services Programs: | | | | |
| Head Start Cluster: | | | | |
| Head Start Program | 93.600 | | - | 16,059,863 |
| COVID-19 - Head Start Program | 93.600 | | - | 81,893 |
| Head Start Disaster Recovery from Hurricanes Harvey, Irma, and Maria | 93.356 | | - | 1,561,395 |
| *Sub-Total Head Start Cluster Programs* | | | - | 17,703,151 |
| Asset for Independence Demostration Program | 93.602 | | - | 201,267 |
| *Sub-Total Direct Programs* | | | - | 17,904,418 |
| Pass-Through Puerto Rico Office of the Ombudsman for the Elderly: | | | | |
| Special Programs for the Aging-Title III, Part B Grants for Supportive Services and Senior Centers (Cluster) | 93.044 | 180169R1 | - | 89,912 |
| Special Programs for the Aging-Title III, Part C Nutrition Services (Cluster) | 93.045 | 180205R1 | - | 97,242 |
| Nutrition Services Incentive Program (Cluster) | 93.053 | 180206R1 | - | 63,027 |
| *Sub-Total Aging Cluster Programs* | | | - | 250,181 |
| Pass-Through Puerto Rico Department of Familiy: | | | | |
| Temporary Assistance for Needy Families (TANF) | 93.558 | 127-2019-244 | - | 132,918 |
| Child Care and Development Block Grant | 93.575 | G1601PRCCDF | - | 520,288 |
| Family Violence Prevention and Services/State Domestic Violence Coalitions | 93.591 | 2014-000107 | - | 30,833 |
| *Total U.S. Department of Health and Human Services Programs* | | | - | 18,838,638 |

continue

| *Federal Grantor/Pass-Through Grantor/Program or Cluster Title* | *Federal CFDA Number* | *Pass-Through Entity Identifying Number* | *Passed Through to Subrecipients* | *Total Federal Expenditures* |
|---|---|---|---|---|
| U.S. Department of Homeland Security Programs: | | | | |
| Pass-Through the Puerto Rico Office of Disaster and Emergencies Administration: | | | | |
| Disaster Grants - Public Assistance (Presidentially Declared Disasters) | 97.036 | FEMA-DR-4339-PR | $ - | $ 4,857,811 |
| Pass-Through the Puerto Rico Office of Public Safety: | | | | |
| Homeland Security Grant Program | 97.067 | EMW-2016-SS-00031-S01 | - | 137,735 |
| *Total U.S. Department of Homeland Security Program* | | | - | 4,995,546 |
| ***Total Expenditures of Federal Awards*** | | | **$ 78,389** | **$ 40,161,470** |

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

## 1. REPORTING ENTITY

The Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico (Municipality), was founded in 1775, and operates as a governmental unit of the Commonwealth of Puerto Rico under the Law No. 81 of August 30, 1991, known as the "Autonomous Municipalities Laws of the Commonwealth of Puerto Rico". It is governed by a Mayor and a 16-member Municipal Legislature elected for a four-year term.

## 2. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (Schedule) includes the federal award activities of the Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico (Municipality) under programs of the Federal government for the fiscal year ended June 30, 2020. The information in this Schedule is presented in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, (Uniform Guidance). Because the Schedule presents only a selected portion of the operations of the Municipality, it is not intended to and does not present the financial position, changes in net position, or cash flows of the Municipality.

## 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Expenditures reported on the Schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

B. Negative amounts, if any, shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years.

C. Pass-through entity identifying numbers are presented where available.

D. The Municipality has elected not to use the 10 percent de minimis indirect cost rate, instead a 5% or 6% of approved budget for the Head Start Program was granted, for a total of indirect costs appropriated of $139,315. The amount of $139,315 expended as indirect cost was included in the expenditures reported on SEFA for the Head Start Program.

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

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

## 5. FEDERAL CFDA NUMBER

The CFDA numbers included in this Schedule are determined based on the program name, review of grant contract information and the Office of Management and Budget's Catalogue of Federal Domestic Assistance.

## 6. OUTSTANDING LOANS OF FEDERAL FUNDS

Federal funded loans provided under these programs are included as expenditure on the schedule of expenditure of Federal Awards. Per Uniform Guidance, loans proceed that were received and expended in prior years are not considered federal awards expended (and thus not shown on the schedule of expenditures of federal awards) as those loans do not include continuing compliance requirements other than repayment of the loans. The Municipality is required to identify in the notes to the schedule of expenditures awards the balances outstanding at the end of the period. On June 30, 2020, the Community Disaster Loans Program, CFDA 97.030, had an outstanding loan balance of $5,000,000, and Community Facilities Loan Program CFDA 10.766, $661,000.

continue

## 7. LATENESS OF SINGLE AUDIT REPORTING PACKAGE

The Single Audit reporting package, as defined and required in 2 CFR 200 for fiscal year ended June 30, 2020, could not be submitted in a timely manner because of the effects of the Novel Coronavirus COVID-19. As further discussed in the Municipality's Notes to the Financial Statements included in its audited financial statements for the same year, the Municipality's activities were affected by the Executive Order issued by the Governor of Puerto Rico.

The Compliance Supplement Addendum released in December of 2020 on page 117 states: "Due to the large size of the COVID-19 programs and the federal government dependency on single audit reports to assist with proper oversight over these funds, we strongly encourage the auditees and auditors to complete and submit their relevant portions of single audit reporting packages for fiscal year ends, subject to the provisions of the extension described herein, as early as possible prior to the normal due dates of the earlier of thirty days after the receipt of the auditor's reports or nine months after the fiscal year end date. In light of the late issuance of audit guidance for the COVID-19 programs contained in this addendum, awarding agencies, in their capacity as cognizant or oversight agencies for audit, must allow recipients and subrecipients that received COVID-19 funding with original due dates from October 1, 2020, through June 30, 2021, an extension for up to three (3) months beyond the normal due date in the completion and submission of the Single Audit reporting package. No further action by awarding agencies is required to enact this extension.

Further, on March 19, 2021, the OMB issued the M-21-20, stated that: "Awarding agencies, in their capacity as cognizant or oversight agencies for audit, should allow recipients and subrecipients that have not yet filed their single audits with the Federal Audit Clearinghouse as of the date of the issuance of this memorandum that have fiscal year-ends through June 30, 2021, to delay the completion and submission of the Single Audit reporting package, as required under Subpart F of 2 CFR §200.501 to six months beyond the normal due date. No further action by awarding agencies is required to enact this extension. This extension does not require individual recipients and subrecipients to seek approval for the extension by the cognizant or oversight agency for audit; however, recipients and subrecipients should maintain documentation of the reason for the delayed filing. Recipients and subrecipients taking advantage of this extension would still qualify as a "low-risk auditee" under the criteria of 2 CFR § 200.520(a). (2 CFR § 200.501)".

## 8. RELATIONSHIP TO STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE – GOVERNMENTAL FUND

Expenditures of federal awards are reported in the Municipality's *Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Fund* as follows: General Fund - $2,663,933, Capital Projects Fund – $4,393,967, Health and Human Services Fund – $18,637,371, and Other Governmental Funds $14,466,199.

**END OF NOTES**

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

**To the Honorable Mayor and**
**Members of the Municipal Legislature**
**Autonomous Municipality of Caguas of the**
**Commonwealth of 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 **Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico** (**Municipality**), as of and for the fiscal year ended June 30, 2020, and the related notes to the financial statements, which collectively comprise **Municipality**'s basic financial statements, and have issued our qualified report thereon dated May 27, 2021. Our report on governmental activities was qualified because we were unable to obtain sufficient appropriate audit evidence about the amounts reported as deferred outflows/inflows of resources, liability, expenses related notes disclosure with respect to its participation in the employees' retirement pension and post-employment benefits plans.

### *Going Concern*

The **Municipality** is an instrumentality of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statements includes an emphasis-of-matter paragraph describing conditions, discussed in Note 26 to the basic financial statements, that raised substantial doubt about the Commonwealth of Puerto Rico's ability to continue as a going concern.

### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered **Municipality**'s internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **Municipality**'s internal control. Accordingly, we do not express an opinion on the effectiveness of **Municipality**'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 **Municipality**'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 **Municipality**'s financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the **Municipality**'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 Díaz-Martínez, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2022

Caguas, Puerto Rico
May 27, 2021

Stamp No. E438162 of the Puerto Rico Society of Certified
Public Accountants was affixed to the original report.

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

**To the Honorable Mayor and**
**Members of the Municipal Legislature**
**Autonomous Municipality of Caguas of the**
**Commonwealth of Puerto Rico**

## Report on Compliance for Each Major Federal Program

We have audited **Autonomous Municipality of Caguas of the Commonwealth of Puerto Rico** (**Municipality**)'s compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of **Municipality**'s major federal programs for the fiscal year ended June 30, 2020. **Municipality**'s major federal programs are identified in the Summary of Auditors' Result Section of the accompanying Schedule of Findings and Questioned Costs.

### *Going Concern*

The **Municipality** is an instrumentality of the Commonwealth of Puerto Rico (Commonwealth). Our report on the basic financial statements includes an emphasis-of-matter paragraph describing conditions, discussed in Note 26 to the basic financial statements, that raised substantial doubt about the Commonwealth of Puerto Rico's ability to continue as a going concern.

### *Management's Responsibility*

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on compliance for each of **Municipality**'s major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about **Municipality**'s compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of **Municipality**'s compliance.

***Opinion on Each Major Federal Programs***

In our opinion, the **Municipality** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the fiscal year ended June 30, 2020.

***Other Matters***

**Report on Internal Control Over Compliance**

Management of **Municipality** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered **Municipality**'s internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of **Municipality**'s internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

***Purpose of this Report***

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

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Caguas, Puerto Rico
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# PART III

# FINDINGS AND QUESTIONED COSTS

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## SECTION I – SUMMARY OF AUDITORS' RESULTS

**Financial Statements**

Type of auditor's report issued on whether the financial statements audited were prepared in accordance with GAAP:

☒ Unmodified Opinions
- Governmental Fund Financial Statements

☒ Qualified Opinion
- Government-wide Financial Statements

☐ Adverse Opinion ☐ Disclaimer Opinion

Internal control over financial reporting:

- Material weakness (es) identified? ☐ Yes ☒ No
- Significant deficiency (ies) identified? ☐ Yes ☒ None Reported

Noncompliance material to financial statements noted? ☐ Yes ☒ No

**Federal Awards**

Internal control over major Federal programs:

- Material weakness (es) identified? ☐ Yes ☒ No
- Significant deficiency (ies) identified? ☐ Yes ☒ None Reported

Type of auditor's report issued on compliance for Major Federal Programs:

☒ Unmodified Opinion
☐ Qualified Opinion
☐ Adverse Opinion ☐ Disclaimer Opinion

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)? ☐ Yes ☒ No

Identification of Major Federal Programs:

| CFDA Number | Name of Federal Program or Cluster |
|---|---|
| 10.558 | Child and Adult Care Food Program |
| 21.019 | Coronavirus Relief Fund |
| 84.287 | Twenty-First Century Community Learning Centers |
| 93.600; 93.356 | Head Start Cluster Program |

Dollar threshold used to distinguish between Type A and Type B Programs: $1,204,844

Auditee qualified as low-risk auditee? ☐ Yes ☒ No

continue

## SECTION II – FINANCIAL STATEMENT FINDINGS

**Our audit disclosed no findings that are required to be reported herein under the *Government Auditing Standards*.**

continue

## SECTION III – FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

**Our audit disclosed no findings that are required to be reported herein under the *Uniform Guidance*.**

## END OF SCHEDULE

**(1) Audit Findings that have been Fully Corrected:**

**FISCAL YEAR 2019**

**Findings Related to the Federal Programs:**

| | | |
|---|---|---|
| **Finding Number** | **2019-001** | **Allowable Costs/Costs Principles**<br>Incorrect requested grant funds. |
| **CFDA Number** | 93.600 | |
| **Questioned Cost** | None | |
| **Auditee Comments** | By letter dated May 22, 2020, Oversight Agency closed this finding. | |

**(2) Audit Findings not Corrected or Partially Corrected:**

**FISCAL YEAR 2018**

**Findings Related to the Federal Programs:**

| | | |
|---|---|---|
| **Finding Number** | **2017-001** | **Eligibility**<br>Missing document in the participant's files. |
| **CFDA Number** | 93.575 | |
| **Questioned Cost** | None | |
| **Auditee Comments** | No final determination has been received from awarding agency. | |

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

**NONE**

**(4) Audit findings is no longer valid:**

**NONE**

**END OF SCHEDULE**