

AUDITED FINANCIAL STATEMENTS

OFFICE OF GOVERNMENT ETHICS OF THE
COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required
Supplementary Information as of and
for the year ended June 30, 2019
and Independent Auditors' Report

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2019

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INDEPENDENT AUDITORS' REPORT

Mr. Luis A. Pérez Vargas, Executive Director
Office of Government Ethics of the Commonwealth of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities and each major fund of the Office of Government Ethics of the Commonwealth of Puerto Rico (a component unit of the Commonwealth of Puerto Rico), as of and for the year ended June 30, 2019, which collectively comprise the Office's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion 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. 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 controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal controls. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Auditors' Responsibility - (Cont'd)

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

Basis for Qualified Opinion and Notes to Disclosure Regarding Pension

As discussed in Notes A and F to the basic financial statements, the Office has not implemented the requirements of Statement No. 68 of the Government Accounting Standard Board, Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27. Accordingly, the Office has not been able to determine and account for its proportionate share of net pension obligation, deferred inflow of resources and deferred outflow of resources related to pension costs and has not recognized the effect of current period changes in net pension obligation, deferred outflow of resources and deferred inflow of resources as these relate to pension costs.

Accounting principles generally accepted in the United States of America require that pension related liability, deferred outflow of resources, deferred inflow of resources, as applicable, be recognized in accordance with the parameters established by Statement No. 68, as well as the effect of current period changes of the aforementioned amount that must be recognized in pension expense during the current period. Recognition of these amounts would increase liabilities, increase deferred outflow of resources, increase deferred inflow of resources, decrease the net position, and change the pension expense. The amount by which this departure would affect liabilities, deferred outflow of resources, deferred resources, deferred inflow of resources, position, and expense has not been determine.

The accompanying notes to the basic financial statements do not disclose the pension cost information required by Statement No. 68. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

Qualified Opinion

In our opinion, except for the possible effects of the matter described above in the Basis for Qualified Opinion and Note Disclosure Regarding Pension paragraph, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of the Office of Government Ethics of the Commonwealth of Puerto Rico (a component unit of the Commonwealth of Puerto Rico) as of June 30, 2018 and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.



Emphasis of a Matter

Financial Deterioration of the Commonwealth of Puerto Rico (Commonwealth)

As discussed in Note B to the basic financial statements, the Office is reported as part of the Commonwealth. Considering that the Office has a significant financial dependency on the Commonwealth, the financial condition and liquidity of the Office could be negatively impacted.

The accompanying financial statements have been prepared assuming the Office will continue as a going concern, as described in Note B.

As described in Note D to the basic financial statements, as of June 30, 2019, the Office's government-wide statement of net position (deficit) reflect a net deficit of \$33,329,924 in its governmental activities. Such deficit is mostly attributed to the recognition of net pension liability. Accordingly, the Office is completely dependent from the Commonwealth of Puerto Rico to pay its long term debt and effectively reverse its deficit position.

As discussed in Note C to the basic financial statements, the fund balance at the beginning of year has been restated to present a change in reporting entity and a change in accounting principle. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information Omitted



Other Matters - (Cont'd)

Required Supplementary Information Omitted (Cont'd)

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 5 to 8 and 35 to 37 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries to 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.

December 17, 2019

Stamp E398429 of the P.R.
Society of Certified Public
Accountants has been affixed
to the file copy of this report.

PSV & Co PSC



OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

This section presents a narrative overview of the financial performance of the Office of Government Ethics of the Commonwealth of Puerto Rico (the "Office") as of and for the year ended June 30, 2019. The information presented herein should be read in conjunction with the Office's basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- Net position of the Office increased \$1.35 million, from \$8.05 million as of June 30, 2018 to \$9.4 million as of June 30, 2019.
- Capital expenditures made during the fiscal year ended 2019 amounted to \$162 thousand.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements consist of two parts, management's discussion and analysis (this section) and the basic financial statements. The basic financial statements include two types of statements that present different views of the Office:

- The first two statements are the government-wide financial statements that provide information about the Office's overall financial position and results. These statements, which are presented on the accrual basis of accounting, consist of the statement of net position and the statement of activities.
- The remaining statements are fund financial statements of the Office's major governmental fund, for which activities are funded primarily from Commonwealth appropriations and for which the Office follows the modified accrual basis of accounting.
- The basic financial statements also include the notes to financial statements section that explains some of the information in the government-wide and fund financial statements and provides more detailed data.

The government-wide financial statements report information about the Office as a whole using accounting methods similar to those used by private sector companies. The statement of net position includes all of the Office's assets and liabilities. All current year revenues and expenses are accounted for in the statement of activities regardless of when the cash is received or paid.

Adoption of New Accounting Pronouncements

As discussed in Note C and D to the financial statements, the Authority adopted the provisions of Governmental Accounting Standards Board ("GASB") Statement No. 68, Accounting and Financial Reporting for Pensions - an amendment of GASB 27, and the related GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to Measurement Date- an amendment to GASB Statement No 68 effective July 1, 2016.

As a result, the Office has determined that a restatement to the July 1, 2016 beginning net position (deficit) was required to recognize the change in accounting principle for the implementation of GASB Statement No. 68 and GASB Statement No. 71 through which accounting for pension plans and the related disclosure requirements were modified.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

FUND FINANCIAL STATEMENTS

The fund financial statements provide more detailed information about the Office's most significant funds and not the Office as a whole. The Office has a type of fund:

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

FINANCIAL ANALYSIS OF THE OFFICE AS A WHOLE

We provide the readers of these basic financial statements with the following summarized discussion and analysis of the relevant facts that affected the government-wide financial statements as of June 30, 2019 and 2018:

	<u>2019</u>	<u>2018</u>	<u>Governmental activities</u> <u>Change</u>	<u>Percentage</u>
Assets:				
Cash	\$ 4,104,970	\$ 6,033,040	\$ (1,928,070)	-31.96%
Certificate of deposit	-	3,000,000	(3,000,000)	-100.00%
Accounts receivable	6,946	150,222	(143,276)	-95.38%
Prepaid expenses	23,233	21,685	1,548	7.14%
Deferred financing cost	-	13,212	(13,212)	(41.12%)
Capital assets:				
Non depreciable	2,000,000	2,000,000	-	0.00%
Depreciable - net	5,243,302	5,509,003	(265,701)	(7.54%)
Total assets	\$ 11,378,451	\$ 16,727,162	\$ (5,348,711)	-31.98%
Liabilities:				
Current liabilities	\$ 1,088,461	\$ 1,219,600	\$ (131,139)	(6.74%)
Non-current liabilities	43,619,914	50,183,908	(6,563,994)	(2.79%)
Total liabilities	44,708,375	51,403,508	(6,695,133)	(3.37%)
Net position (deficit):				
Invested in capital assets	7,243,302	804,386	6,438,916	(15.61%)
Unrestricted	(40,573,226)	(35,480,732)	(5,092,494)	14.35%
Total net position (deficit)	(33,329,924)	(34,676,346)	1,346,422	-3.88%
Total liabilities and net position (deficit)	\$ 11,378,451	\$ 16,727,162	\$ (5,348,711)	-31.98%

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

FINANCIAL ANALYSIS OF THE OFFICE AS A WHOLE (Cont'd)

Net position of the Office increased \$1.35 million, from \$8.05 million as of June 30, 2018, to \$9.40 million as of June 30, 2019. The increase in net position was the result of a net decrease of \$5.35 million in total assets and a decrease of \$6.70 million in total liabilities. The increase in total assets and the decrease in total liabilities are mainly due to the following:

- Total assets decrease mainly due to decrease in cash and certificate of deposit partially offset by a change in accumulated depreciation.
- Total liabilities decreased by \$6.70 million mainly due to a decrease of \$6.71 million of long term debt of mortgage and offset by increase in accrued expenses of \$.01 million. The Office paid the balance due to long-term debt at December 2018 amounting to \$6.71 million.

The statement of activities shows the sources of the Office's changes in net position as they arise through its various functions. The Office currently only has governmental activities. Condensed statements of activities for the fiscal years ended June 30, 2019 and 2018 are shown in the table below:

	<u>2019</u>	<u>Governmental activities</u> <u>2018</u>	<u>Change</u>	<u>Percentage</u>
Revenues:				
Program revenues:				
State appropriations.	\$ 8,951,000	\$ 9,278,000	\$ (327,000)	-3.52%
Special state appropriation. . .	-	25,000	(25,000)	(10.30%)
Interests and other.	79,542	319,986	(240,444)	-75.14%
Total revenues.	<u>9,030,542</u>	<u>9,622,986</u>	<u>(592,444)</u>	-6.16%
Expenditures:				
General government.	7,421,970	7,694,731	(272,761)	(10.83%)
Expenditures from specific program:				
Special projects.	-	22,415	(22,415)	(10.34%)
Interests on long - term debt.	262,150	536,306	(274,156)	(5.15%)
Total expenses.	<u>7,684,120</u>	<u>8,253,452</u>	<u>(569,332)</u>	(10.48%)
Change in net position.	1,346,422	1,369,534	(23,112)	-1.69%
Net position at:				
Beginning of year, as restated.	<u>(34,676,346)</u>	<u>(36,045,880)</u>	<u>1,369,534</u>	-3.80%
End of year.	<u>\$ (33,329,924)</u>	<u>\$ (34,676,346)</u>	<u>\$ 1,346,422</u>	-3.88%

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

FINANCIAL ANALYSIS OF THE OFFICE AS A WHOLE (Cont'd)

Function/program expenses decreased from \$8.25 million in 2018 to \$7.68 million in 2019. The positive variance was mainly caused by decreases of regular employees salaries and the related payroll expenses.

GOVERNMENTAL FUND RESULTS

Following is an analysis of the results of operations of the Office's major governmental funds General Fund - this fund accounts for all of the Office's activities. Total expenditures of this fund increase \$6.17 million from \$7.93 million in 2018 to \$14.10 million in 2019. The increase was mainly due to the long term debt payment combined with a decrease in other expenditures.

CAPITAL ASSETS

The Office's investment in capital assets at June 30, 2019 and 2018 amounted to approximately \$7.2 million and \$7.51 million, respectively, net of accumulated depreciation and amortization. Capital assets include land, buildings, building improvements, office furniture equipment, computer equipment, vehicles and intangible assets including software. See Note G included in the basic financial statements for additional details on capital assets at year-end and on activity during the fiscal year ended June 30, 2019.

LONG-TERM DEBT

The Office has a long-term debt used to finance the acquisition of a building for its administrative office. On December 2018, the Office paid the long-term debt balance amounting to \$6,661,302.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Office's finances. Questions concerning the information provided in this report or requests for additional financial information should be addressed to the Office of the Executive Director, Office of Government Ethics of the Commonwealth of Puerto Rico, Ganges Street 108, Urbanización El Paraiso, San Juan, Puerto Rico, 00926-2906.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET POSITION

JUNE 30, 2019

- ASSETS -

Current assets:

Cash	\$	4,104,970
Accounts receivable		6,946
Prepaid expenses		<u>23,233</u>
Total current assets		<u>4,135,149</u>

Capital assets:

Non depreciable		2,000,000
Depreciable - net		<u>5,243,302</u>
Total capital assets		<u>7,243,302</u>
Total assets		<u>11,378,451</u>

- LIABILITIES AND NET POSITION -

Current liabilities:

Accrued compensated absence		532,913
Accounts payable		199,184
Accrued expenses		<u>356,364</u>
Total current liabilities		<u>1,088,461</u>

Non-current liabilities:

Net pension liability		42,729,384
Accrued compensated absence		<u>890,530</u>
Total liabilities		<u>44,708,375</u>

Net position:

Invested in capital assets		7,243,302
Unrestricted		<u>(40,573,226)</u>
Total net position	\$	<u>(33,329,924)</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

<u>Functions and programs</u>	<u>Expenses</u>	<u>Program revenues</u>		Net revenues (expenses) and changes in net position
		<u>Operating Grant and Contributions</u>	<u>Other Sources</u>	
Governmental activities:				
General government	\$ (7,421,970)	\$ 8,951,000	\$ 79,542	\$ 1,608,572
Interests on long term debt	<u>(262,150)</u>	<u>-</u>	<u>-</u>	<u>(262,150)</u>
Total governmental activities and change in net position	<u>\$ (7,684,120)</u>	<u>\$ 8,951,000</u>	<u>\$ 79,542</u>	1,346,422

NET POSITION AT:

BEGINNING OF YEAR, AS RESTATED	<u>(34,676,346)</u>
END OF YEAR	<u>\$ (33,329,924)</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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BALANCE SHEET - GOVERNMENTAL FUND
JUNE 30, 2019

	<u>General fund</u>
ASSETS:	
Cash	\$ 4,104,970
Accounts receivable	<u>6,946</u>
Total assets	<u>\$ 4,111,916</u>
LIABILITIES:	
Accrued compensated absence	\$ 532,913
Accounts payable	199,184
Accrued expenses	<u>356,364</u>
Total liabilities	<u>1,088,461</u>
FUND BALANCE:	
Unrestricted	<u>3,023,455</u>
Total funds	<u>3,023,455</u>
Total liabilities and fund balance	<u>\$ 4,111,916</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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BALANCE SHEET RECONCILIATION - GOVERNMENTAL
FUND TO THE STATEMENT OF NET POSITION JUNE 30, 2019

Amounts reported for governmental activities in the
statement of net assets are different because:

Total fund balance	\$	3,023,455
Prepaid expenses are not available to pay current period expenditures and, therefore, are not deferred in the funds		23,233
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the Balance Sheet - Governmental Fund		7,243,302
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the Balance Sheet - Governmental Fund:		
Net pension liability		(42,729,384)
Accrued compensated absence		<u>(890,530)</u>
Net position of governmental activities	\$	<u>(33,329,924)</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - GOVERNMENTAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	<u>General fund</u>
REVENUES:	
State appropriations	\$ 8,951,000
Other income	8,814
Interest and investment income	<u>70,728</u>
 Total revenues	 <u>9,030,542</u>
EXPENDITURES:	
Payroll and related expenses	6,316,022
Capital outlays	162,056
Insurance and related expenses	171,777
Office equipment and supplies	202,324
Other expenses	42,449
Rent related expenses	24,098
Repair and maintenance	82,107
Special projects	11,891
Professional services	57,681
Utilities	71,104
Debt service payments:	
Principal	6,704,618
Interest	<u>262,150</u>
 Total expenditures	 <u>14,108,277</u>
 Net change in fund balances - governmental funds	 <u>(5,077,735)</u>
FUND BALANCE AT:	
 BEGINNING OF YEAR	 <u>5,482,653</u>
 END OF YEAR	 <u>\$ 404,918</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF STATEMENT OF REVENUE,
EXPENDITURES AND CHANGES IN FUND BALANCE -
GOVERNMENTAL FUND TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2019

Amounts reported for governmental activities in the
statement of net assets are different because:

Net change in fund balance - governmental funds	\$ (5,077,735)
The issuance of long-term debt provides current financial resources while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds; neither transaction, however, has any effect on net assets.	6,704,618
Some expenses in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditure in governmental funds	(13,212)
Governmental funds report prepaid expenses as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as amortization expense. This is the amount by which these expenditures exceeded amortization in the current period.	(1,548)
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense and amortization. This is the amount by which capital outlays, net of disposals, exceeded depreciation in the current period.	(265,701)
CHANGE IN NET POSITION OF GOVERNMENTAL ACTIVITIES	\$ <u>1,346,422</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

NOTE A - REPORTING ENTITY

The Office of Government Ethics of the Commonwealth of Puerto Rico (the "Office") was created by Act No. 12 of July 24, 1985, as amended, (the "Act") by the Legislature of the Commonwealth of Puerto Rico (the "Legislature"). The Office was created to promote and preserve the integrity of public servants in government institutions. To promote administrative independency, the Office is a separate and independent entity from any other agency or instrumentality of the Commonwealth of Puerto Rico (the "Commonwealth"). On January 3, 2012, the Legislature enacted Act 1-2012, known as the Puerto Rico Government Ethics Act of 2011. The main purpose established in the Act is to renew and reassert the preventive and overseeing duties of the Office. Its policies enable the Office to identify, analyze, and provide education on values such as trustworthiness, caring, fairness, citizenship, respect, and responsibility, which makes feasible the attainment of the highest levels of honesty, conscientiousness, and efficiency in performance of public servants. Furthermore, the office oversees, through the vehicles and resources provided by the Act, the conduct of public servants and penalizes all those who infringe the code of ethics, incorporate values into public service. The Office receives significant financial support from the Commonwealth in the form of contributions.

In section 8.3, Act No. 12 of July 24, 1985, as amended, was repealed, except for the creation of the Office, the appointments, right and privileges vested, and contracts, arrangements, agreements entered there under. This repeal shall not affect any proceeding initiated or that may be initiated, pursuant to the provisions of the cited Act.

The Office is required to submit a quarterly report as established in section 4, Act No. 166 of June 17, 2014, also known as the "Special Law for Fiscal and Operational Sustainability of the Commonwealth of Puerto Rico" to the Governor of Puerto Rico, Secretary of the Puerto Rico Senate and House of representative.

The Office is exempt from all taxation in Puerto Rico. Also pursuant to both Acts, the office is exempt of the following:

Act No 3 of January 23, 2017 also known as the "Ley para atender la crisis económica , fiscal y presupuestaria para garantizar el funcionamiento del gobierno de Puerto Rico" with the exception of Article 9 and Article 26 which are the only ones that the office is not exempt from in this act.

Act No. 8 of February 4, 2017 , also known as the "Ley para la Administración y la transformación de los recursos humanos en el Gobierno de Puerto Rico".

Act No. 230 of July 23, 1974, as amended, also known as the "Puerto Rico Government Accounting Act".

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NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

NOTE A - REPORTING ENTITY (Cont'd)

Act No. 184 of August 3, 2004, as amended, also known as the "Public Service Human Resources Administration Act of the Commonwealth of Puerto Rico".

Act No. 45 of February 25, 1998, as amended, known as the "Puerto Rico Public Service Labor Relations Act".

Act No. 54 of January 4, 2003, related to the exclusive Register of Bidders.

Act No. 147 of June 18, 1980, as amended, known as the "Management and Budget Office Organic Act".

Act No. 197 of August 18, 2002, known as the "Act to Regulate the Transition Process of the Government of Puerto Rico".

Act No. 209 of August 28, 2003, known as the "Puerto Rico Institute of Statistics Act".

Act No. 265 of September 3, 2003, known as the "Act for Regulating Certain Government Financing and Personal Property Leasing Contracts".

Act No. 5 of December 8, 1955, as amended, known as the "Public Documents Administration Act".

Act No. 15 of February 28, 2017 as amended, also known as the "Ley del Inspector General de P.R.".

The Office's accompanying financial statements are issued solely for the information and use of the Office management and is not intended to be and should not be used by anyone other than these specified parties.

NOTE B - GOING CONCERN

As part of its normal operating activities, the Office, is part of and receives significant financial support from the General Fund of the Commonwealth of Puerto Rico. As of June 30, 2019, the Commonwealth faces significant budgetary risks and uncertainties, including liquidity risk; which is the risk of not having sufficient liquid financial resources to meet their obligations when they become due. However, the Office of Government Ethics of the Commonwealth of Puerto Rico as a result of its operational efficiencies, savings and budget controls, does not foresee any possible effect of the aforementioned Commonwealth financial uncertainty on its basic financial statements and operations. The Office will continue to operate with the necessary cash flow for a period of 12 months since the issue date of the present financial statements.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

NOTE B - GOING CONCERN (Cont'd)

It is of outmost importance to understand that as established in the Puerto Rico Government Ethics Act of 2011 -“The Office is hereby created with the clear legislative intent to operate with full autonomy and independence and at full capacity on a continuing basis, without external interventions, thus allowing it to carry out its ministerial functions efficiently and effectively, without the influence of any public servant subject to its jurisdiction. This administrative and fiscal autonomy is essential to carry out the delicate function entrusted to the Office.”

In addition, as discussed in Note A, since its creation the Office was exempted from the application of the Act No. 230 of July 23, 1974 , as amended , known as the “ Puerto Rico Government Accounting Act” and Act No. 147 of June 18 , 1980, as amended, known as the “ Management and Budget Office Organic Act”. These acts regulate the use and management of governmental funds in the Commonwealth of Puerto Rico and the exemption from these acts reinforces the financial autonomy of the Office.

NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Office conform to accounting principles generally accepted in the United States of America hereinafter referred to as GAAP, as applicable to governmental entities. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses/expenditures during the reported period. Actual results could differ from those estimates.

Government-wide and fund financial statements

Government-wide financial statements - The statement of net assets and the statement of activities report information on all activities of the Office. The Office only has governmental activities. Governmental activities generally are financed through intergovernmental revenues and other non-exchange revenues. Following is a description of the Office's government-wide financial statements:

The statement of net position presents the Office's assets and liabilities, with the difference reported as net position. Net position are reported in three categories:

Invested in capital assets consists of capital assets, net of accumulated depreciation and amortization, reduced by any outstanding balances for notes and other debt that are attributed to the acquisition, construction or improvement of those assets.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Government wide and fund financial statements (Cont'd)

Restricted net position results when constraints placed on net position use are either externally imposed by creator, grantor, contributor, and the like, or imposed by law through constitutional provision or enabling legislation.

Unrestricted net assets consist of net assets that do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on use that are imposed by management, but such constraints may be removed or modified.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include grants and contributions that are restricted to meeting the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues, if any, are reported as general revenues.

Fund Financial Statements - Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. The Office reports all of its governmental activities in the General Fund and the Federal Grant Fund.

Measurement focus, basis of accounting and financial statements presentation

Government-wide financial statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

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NOTES TO FINANCIAL STATEMENTS
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NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Measurement focus, basis of accounting and financial statements presentation (Cont'd)

Governmental funds financial statements

The governmental funds financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting.

Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Office considers revenues to be available if they are collected within 90 days after the end of the fiscal year. Principal revenue sources considered susceptible to accrual include Commonwealth and federal funds to be received by the Office. Other revenues are considered to be measurable and available only when cash is received. Expenditures generally are recorded when a liability is incurred as under accrual accounting.

Modifications to the accrual basis of accounting include:

- Interest on general long-term obligations is generally recognized when paid.
- Debt service principal expenditures and claims and judgments are recorded only when payment is due.

The Office's governmental activities are accounted for in the following major funds:

- General Fund - This fund accounts for all financial resources of the Office, except for those activities related to Puerto Rico Labor Department as it relates to the Law 52.

Fund balance

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

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

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NOTES TO FINANCIAL STATEMENTS
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NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Fund balance (Cont'd)

- Restricted - amounts constrained to specific purposes by their providers (such as grantors), through constitutional provisions, or by enabling legislation.
- Committed - amounts constrained to specific purposes by the Office itself, using its highest level of decision-making Office (such as legislation). To be reported as committed, amounts cannot be used for any other purpose unless the Office takes the same highest level action to remove or change the constraint.
- Assigned - amounts the Office intends to use for a specific purpose. Intent can be expressed by the Office or by an official or body to which the Office delegates the Office.
- Unassigned - all amounts not included in other spendable classifications.

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

In the general fund, the Office strives to maintain an unassigned fund balance to be used for unanticipated expenditures and other financing sources and uses.

Budgetary accounting

Statutory (budgetary) accounting

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

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

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NOTES TO FINANCIAL STATEMENTS
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NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Budgetary control

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

The Office is not required by the Act to submit a budget for approval by the Legislature of the Commonwealth. The Office received a group appropriation; consequently, no formal budgetary accounting procedures are followed.

Prepaid expenses

Certain payments to vendors represent costs applicable to future accounting periods and are recorded as prepaid items in the government-wide financial statements.

Capital assets

Capital assets, which include land, building, building improvements, computer equipment, office furniture, equipment, motor vehicles and intangible assets including software are reported in the government wide financial statements. Capital assets are defined by the Office as assets which have a cost of \$100 or more at the date of acquisition and have an expected useful life of three or more years. Purchased capital assets are valued at historical cost. Donated fixed assets are recorded at fair value at the date of donation.

Capital assets transferred from other governmental entities within the same financial reporting entity are recorded at the carrying value of the transferor. The costs of normal maintenance and repairs that do not add to the asset's value or materially extend the asset's useful life are not capitalized.

Capital assets are depreciated on the straight-line method over the assets' estimated useful lives generally, estimated useful lives are as follows:

Building	30 years
Building improvement	20 years
Office furniture and equipment	7 years
Computer equipment	3 years
Vehicles	5 years
Software	5 years

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NOTES TO FINANCIAL STATEMENTS
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NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Use of estimates

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

Cash and cash equivalents

The Office considers all highly liquid investments with maturity of ninety (90) days or less when purchased to be cash equivalents. The cash balances are available to meet current operating requirements in various interest-bearing accounts with Commercial Banks.

Compensated absences

The vacation policy of the Commonwealth of Puerto Rico that applies to the Office employees provides for the accumulation of one and a quarter (1.25) days per month. Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of sixty (60) days. Office's employees accumulate sick leave at a rate of one and a half (1.5) days per month up to a maximum of ninety (90) days. Upon retirement, an employee receives all accumulated unpaid leave at the current rate, if the employee has at least ten (10) years of service with the Commonwealth of Puerto Rico.

Governmental funds

Reservations of fund balance

The governmental fund financial statements present reservations of fund balance for portions of fund balances that are legally segregated for a specific future spending, use or are not available for other future spending.

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 include estimates related to contingent liability or liabilities with a fixed or expected due date, which will require future available financial resources for its payment.

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NOTES TO FINANCIAL STATEMENTS
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NOTE C - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Accounting for Pension Costs

The Office accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying basic financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

Effects of New Accounting Standards

During the fiscal year ended June 30, 2019, the Office implemented the following GASB pronouncements

GASB Statement No. 68, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27 - This statement was issued to improve accounting and financial reporting by state and local governments for pensions. This statement replaces requirements of GASB Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as requirements of GASB Statement No. 50, Pension Disclosures. This statement and GASB Statement No. 67 (applicable to Pension Plans) establish a definition of a pension plan that reflects the primary activities associated with the pension arrangement - determining pensions, accumulating and managing assets dedicated for pensions and paying benefits to plan members as they come due. This statement was effective for the fiscal year ended June 30, 2015 but it was not until fiscal year 2019 that was implemented by the Office. Additional information about the implementation of this statement and GASB Statement No. 71 is addressed in the Note 3 and Note 23.

GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68 - The objective of this statement is to address an issue regarding application of the transition provisions of GASB Statement No. 68, Accounting and Financial Reporting for Pensions. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The statement requires that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. This statement is effective for the fiscal year ended June 30, 2015, but it was not until fiscal year 2019 that was implemented by the Office.

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NOTES TO FINANCIAL STATEMENTS
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NOTE D - CHANGE IN REPORTING ENTITY AND ACCOUNTING PRINCIPLE

The Office has determined that a restatement to the July 1, 2018 beginning net position was required to recognize the change in accounting principle for the implementation of GASB Statement No. 68, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27, and Statement No. 71, Pension Transition for Contributions made Subsequent to the Measurement Date - an amendment of GASB Statement No. 68, through which accounting for pension plans and the related disclosure requirements were modified.

This adjustment resulted in a change to the beginning net position of the Office as follows:

Net position, at beginning of year as previously reported	\$ 8,053,038
Prior period adjustment:	
Implementation of GASB Statements No. 68 and No. 71:	
Net pension liability (measurement date June 30, 2016)	<u>(42,729,384)</u>
Net position, at beginning of year as restated	<u>\$ (34,676,346)</u>

NOTE E - CASH

The Office maintains its cash balances in commercial banks. Depository bank accounts at the institution are guaranteed by the Federal Deposit Insurance Corporation up to \$250,000. At June 30, 2019, the cash balances exceeded the insured limit by \$5,862,100.

NOTE F - COMPENSATED ABSENCES

Employees accrue vacation leave at a rate of one and a quarter (1.25) days per month up to a maximum of sixty (60) days. Unpaid vacation time accumulated is fully vested to the employees from the first (1) day of work.

Employee's accrue sick leave at a rate of one and a half (1.5) days per month up to a maximum of ninety (90) days.

Total vested pay benefits accrued for compensated absences at June 30, 2018, amount to \$1,423,443 which activity for the year ended June 30, 2019, is summarized as follows:

<u>Balance at</u> <u>June 30, 2018</u>	<u>Additions</u>	<u>Decrease</u>	<u>Balance at</u> <u>June 30, 2019</u>	<u>Due within</u> <u>One (1) Year</u>
<u>\$ 1,384,317</u>	<u>\$ 600,934</u>	<u>\$ 561,808</u>	<u>\$ 1,423,443</u>	<u>\$ 532,913</u>

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN

All full-time regular employees are covered and must participate in the employee's retirement plan administered by the Employees' Retirement System ("ERS") of the Government of Puerto Rico (created by Act No. 447 in May 15, 1951) and its Instrumentalities.

In 1990, in an effort to withstand the increase in the unfunded liability, the benefit structure was modified to decrease the benefits and to postpone the retirement age from 55 to 65, in order to provide a more affordable benefit structure. Also, the level of contributions was raised and Act No. 447 was amended to provide that any increase in benefits would require actuarial studies and identification of the financing source.

Ten years later, the continue increase in the unfunded liability required further action. As a result, the original defined benefit structure was closed to new plan members joining the System on or after January 1, 2000. To provide a retirement alternative, the pension benefit structure was further amended by Act No. 305 of September 24, 1999 (Act. No. 305) for the purpose of establishing a new pension program named (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the ERS as of December 31, 1999 had the option to stay in the defined benefit plan or transfer to System 2000. Employees joining the Office on or after January 1, 2000 are only allowed to become participants of System 2000. System 2000 is a defined contribution plan, also known as a cash balance plan. Under this new plan, there is a pool of pension assets, which are invested by the ERS, together with those of the current defined benefit plan. Benefits at retirement age are not guaranteed by the Commonwealth. The annuity is based on a formula that assumes that each year the employee's contribution (with a minimum of 8.275% of the employee's salary up to a maximum of 10%) is invested in an account, which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note or (2) earn a rate equal to 75% of the return of the ERS' investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plan showing their accrued balances. System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the ERS on or after April 1, 1990. Disability pensions are not granted under System 2000.

Effective July 1, 2011, the Commonwealth of Puerto Rico implemented the increases in the Retirement System that Retirement System Commission approved for all governmental employees. These increases consist of an increase in the annual employer contribution of 1.0% of the regular retribution received by the participants, beginning on July 1, 2012 and ending on June 30, 2016, and an annual increase of the employer contribution of 1.25% of the regular retribution received by the participant beginning on July 1, 2016 and ending on June 30, 2021.

Total office contributions made for the pension plan during the year ended June 30, 2019 amounted to \$490,590 for employees paid with state funds.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 of 1990 (Act No. 1) and Act No. 305 to establish, among other things, a defined contribution program similar to the System 2000 Program (the Contributory Hybrid Program) to be administered by the Retirement System. All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the Defined Benefit Program and the System 2000 Program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous plans will become part of the Contributory Hybrid Program. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under the Benefit Program, and thereafter, all future benefits will accrue under the defined contribution formula used for 2000 System Program participants. Ceasing future defined benefit accruals under Act No. 1 and converting to a member-funded hybrid plan will result in lower benefit payments as these tiers wind down, and will make all future employers contributions available to pay benefits and bonds payable debt service.

The Act No. 3 of 2013, amends the provisions of the different benefits structures under the ERS, including, but not limited to, the following:

- For active participants of the contributory defined benefit programs under Act No. 447 of 1951 and Act No. 1 of 1990, all retirement benefits accrued through June 30, 2013 will be frozen, and thereafter, all future benefits will accrue under the defined contribution formula used for increases of the minimum pension payments for current retirees from \$400 to \$500 per month.
- The retirement age for Act No. 447 participants will be gradually increased from age 58 to age 61.
- The retirement age for current System 2000 participants is increased gradually from age 60 to age 65.
- Eliminates the "merit annuity" available to participants who joined the ERS prior to April 1, 1990.
- The retirement age for new employees is increased to age 67, except for new state and municipal police officers, firefighters, and custody officers, which will be age 58.
- Increases the employer contribution rate from 16.775% to 18.025%.
- For System 2000 participants, the retirement benefits will no longer be paid as a lump sum distribution, instead, they will be paid through a lifetime annuity.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

- Eliminates or reduces various retirement benefits previously granted by special laws, including Christmas and summer bonuses. The Christmas bonus payable to current retirees is reduced from \$600 to \$200 and is eliminated for future retirees. The summer bonus will be eliminated and the disability benefits will be substituted for a mandatory disability insurance policy.
- Survivor benefits will be modified.
- The Office contributions will increase gradually effective July 1, 2017. The required contribution for fiscal year ending June 30, 2018 will be 16.775%. Subsequently, the required contribution will increase by 1.25% every year up to a total contribution of 20.525%.

Statement No. 68 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27 (GASB 68) became effective for the year ended June 30, 2015. This statement replaces the requirements of Statement No. 27.

Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the ERS.

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions:

As of June 30, 2016, the Office reported a liability of \$42,729,384 for its proportionate share of the net pension liability.

The June 30, 2016 net pension liability was measured as of June 30, 2015 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015, rolled forward to the measurement date of June 30, 2016.

For the year ended June 30, 2019, the Office recognized pension expense of \$490,590 thousand.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

Actuarial Assumptions and Methods:

The actuarial valuation used the following actuarial methods and assumptions applied to all periods in the measurement:

Actuarial cost method:	Entry age normal
Asset valuation method:	Market value of assets
Inflation rate:	2.50%
Salary increases:	3% per year. No compensation increases are assumed until July 1, 2021 as result of Act no 66 and the current general economy.

The mortality tables used in the June 30, 2017 valuation were as follows:

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

100% of deaths while in active service are assumed to be occupied only for members covered under Act No. 127.

Post-Retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of a Plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. The base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

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 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-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

Most other demographic assumptions used in the July 1, 2015 valuation were based on the results of an actuarial experience study using data as of June 30, 2003, 2005, and 2007.

The long term expected rate of return on pension benefits investments was determined in accordance with the asset allocation of the portfolio that was adopted by the Retirement System's Board during December 2013 and the actuary's capital market assumptions as of June 30, 2016. In addition, the assumption reflects that loans to members comprise approximately 50% of the portfolio and, have an approximate return of 9.1% with no volatility. The long term expected rate of return on pension benefits investments of 6.55% at June 30, 2016 is equal to the highest debt service of the senior pension funding bonds payable which range from 5.85% to 6.55% per annum.

The Retirement System's policy regarding allocation of invested assets is established and may be amended by the Retirement System's Board. Plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a positive impact on the System's financial condition for the benefits provided through the pension programs.

The following was the Retirement System's Board adopted asset allocation policy at June 30, 2016:

	<u>Target Allocation</u>	<u>Long-term expected Real rate of return</u>
Asset class:		
Domestic equity	25%	6.40%
International equity	10%	6.70%
Fixed income	64%	6.30%
Cash	1%	3.00%
	<hr/>	
Total	100%	
	<hr/>	

The expected long-term rates of return on pension plan investments were determined using a building block method in which best estimates ranges of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentages and by adding expected inflation.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

The asset basis for the date of depletion is the Retirement System's fiduciary net position (gross assets plus deferred outflows of resources less gross liabilities, including senior pension funding bonds payable, less deferred outflows of resources). On this basis, the Retirement System's net position became negative in fiscal year 2015 and accordingly no projection of date of depletion is needed.

The date of depletion projection of the actuarial report does not include any amounts from the additional uniform contribution required by Act No. 32 because of actual fiscal and budgetary financial difficulties, continued budget deficits and liquidity risks of the Commonwealth and the municipalities, and in the event that their financial condition does not improve in the near term.

Actuarial valuations of an ongoing plan involve estimates of the value of projected benefits and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Therefore, actuarial determined amounts are subject to change in the near term.

Discount rate

The Retirement System's net position was not projected to be available to make all projected future benefit payments on current and active and inactive employees. Therefore, the tax-free municipal bond index (Bond Buyer Obligation 20 Bond Municipal Bond Index) was applied to all periods of projected benefits payments to determine total pension liability. The discount rate was 2.85% at June 30, 2016.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

Sensitivity of the Office's proportionate share of net pension liability to change in the discount rate

The following table presents the Office's proportionate share of the net pension liability calculated using the current discount rate of 2.85% as well what the Office's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one percentage point lower or one percentage point higher than the current rate:

	At 1% decrease (1.85%)	At current discount rate (2.85%)	At 1% increase (3.85%)
Net pension liability.	<u>\$ 49,327,219</u>	<u>\$ 42,729,384</u>	<u>\$ 37,860,887</u>

Payable to the Retirement System

As of June 30, 2016, the Office reported a payable of approximately \$42,729,384 for the outstanding amount of contributions to the Retirement System for current year.

Pension plan fiduciary net position

Additional information on the Retirement System is provided on its standalone financial statements for the year ended June 30, 2016, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico.

As of the date of the release of this report, the ERS has not issued its 2019, 2018 and 2017 basic financial statements, nor has it provided the Office with the required information to implement the requirements of Statement No. 68 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27 (GASB 68). Therefore, the accompanying governmental activities financial statements do not have any adjustments that will be necessary for the Office to account for its proportionate share of the net pension liability, deferred inflow of resources and deferred outflow of resources in the statement of net assets as of June 30, 2019, as well as the effect in the recorded pension expense in the statement of activities for the year ended June 30, 2019.

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NOTES TO FINANCIAL STATEMENTS
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NOTE G - RETIREMENT PLAN (Cont'd)

The pension costs recognized in the accompanying financial statements are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions, which is not in accordance with accounting principles generally accepted in the United States of America. Additional information on the ERS is provided in its financial statements for the year ended June 30, 2019 a copy of which can be obtained from the Administrator of the Retirement System: P.O. Box 42003, San Juan, Puerto Rico 00940.

Effective July 1, 2017, the Government of Puerto Rico adopted the “PayGo” mechanism for all of its retirement systems. By means of this mechanism, agencies and instrumentalities are responsible for putting up the money to pay pensions. With the implementation of this charge employers’ contributions, contributions ordered by special laws and the Additional Uniform Contribution (Law 32-2013) were all eliminated and replaced by the “PayGo Charge” that is collected from government entities to pay retirees.

The systems affected by the change are the government’s, the judiciary, the University of Puerto Rico and those of public corporations. The Treasury Department will bill public corporations, municipalities, the central government, the Legislature and the judicial branch a monthly charge to cover the benefits to pensioners. The charge must be submitted to the Treasury Department on or before the fifteen (15th) of each month along with the individuals’ contribution withheld that must be sent to a different bank account as established on Circular Letter Num. 1300-46-17. If the public corporation, municipality or any other participating entity of the Retirement System fails to comply with the corresponding payment within thirty (30) days from retention, the funds from “PayGo Charge” or the individuals’ contributions withheld from participating employees, the Treasury Department will withhold from any available remittance the amount due to cover for the debt. In case of municipalities, the amount due will be requested to the Centro de Recaudaciones e Ingresos Municipales “CRIM” so that available remittances be used to cover for the debt.

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NOTES TO FINANCIAL STATEMENTS
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NOTE H - CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2019 was as follows:

	Beginning <u>Balance</u>	<u>Increase</u>	Decrease other and <u>Reclassification</u>	Ending <u>Balance</u>
Non depreciable:				
Land	\$ 2,000,000	\$ -	\$ -	\$ 2,000,000
Depreciable:				
Building	5,375,421	-	-	5,375,421
Building improvements	2,204,698	42,659	-	2,247,357
Office furniture and equipment	1,875,957	48,416	(223)	1,924,150
Computer equipment	927,442	70,981	(43)	998,380
Vehicle	254,377	-	-	254,377
Software	522,750	-	-	522,750
Total capital assets	<u>13,160,645</u>	<u>162,056</u>	<u>(266)</u>	<u>13,322,435</u>
Less: accumulated depreciation:				
Building	1,551,756	179,181	-	1,730,937
Building improvements	823,355	112,569	-	935,924
Office furniture and equipment	1,721,409	47,231	(223)	1,768,417
Computer equipment	828,481	38,981	(43)	867,419
Software	480,857	41,109	-	521,966
Vehicle	245,784	8,686	-	254,470
Total accumulated depreciation .	<u>5,651,642</u>	<u>427,757</u>	<u>(266)</u>	<u>6,079,133</u>
Total capital assets - net	<u>\$ 7,509,003</u>	<u>\$ (265,701)</u>	<u>\$ -</u>	<u>\$ 7,243,302</u>

During the year 2019, the Office depreciation and amortization expense amounted to \$595,039.

In accordance with the provisions of the Accounting of the Impairment or Disposal of Long-Lived Assets, Topic of the FASB Accounting Standard Codification management reviews long-lived assets for impairment when circumstances indicate the carrying amount of an asset may not be recoverable. If the carrying amount of an asset may not be recoverable, a write-down to fair value is recorded. Fair values are determined based on the discounted cash flows, quoted market values, or external appraisals, as applicable. As of June 30, 2019, management believes that long-lived assets are not impaired at the individual asset or group level.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2019

NOTE I - CONTINGENCIES

At June 30, 2019 the Office is involved in various litigations arising in the normal course of operations. The Office believes that its ultimate liability, if any, in connection with these matters will not have a material effect on the Office financial condition and results of operations. Based on the advice of legal counsel, management has an accrued estimate for litigation and claim losses of \$290,000 in fiscal year June 30, 2018. For the fiscal year June 30, 2019, the Office did not accrued additional expense for this contingency. Any claims with negative financial impact would be paid from the general funds of the Commonwealth of Puerto Rico.

Voluntary Termination Benefits - During the fiscal year the office established two programs with economic incentives for early retirement or voluntary employment termination to eligible employees in accordance with section 22 of Act 70 of July 2, 2010. The program established in October 2010 has the first two components described below. The second program established on February 2012 has three (3) components as follows:

- Economic incentives for early retirement - All employees that at September 30, 2010 have completed between 15 to 29 years of creditable service in the Retirement System, regardless their age, may receive pension benefits ranging from 37.5% to 50% of each employee's salary, depending on the years of service.
- Economic incentives for resignation - All employees can resign and receive an economic incentive of one (1) month up to six (6) months of salary depending of the employee's term in the public services. The payment will be exempted from income tax payment and will not be subject to savings and retirement plan deductions.

NOTE J - SUBSEQUENT EVENTS

Management has evaluated subsequent events through December 17, 2019, the date the financial statements were available to be issued.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

BUDGETARY COMPARISON SCHEDULE
GENERAL FUND (UNAUDITED)
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	Original <u>Budget</u>	Final <u>Budget</u>	Actual <u>Expenditures</u>	<u>Variance</u>
Revenue:				
State appropriation	\$ 9,278,000	\$ 8,951,000	\$ 8,951,000	\$ -
Total revenues	<u>9,278,000</u>	<u>8,951,000</u>	<u>8,951,000</u>	<u>-</u>
Expenditures:				
Payroll and related expenses . . .	6,612,032	7,224,977	6,316,022	(908,955)
Capital outlays	114,223	114,223	162,056	47,833
Insurance and related expenses .	148,404	175,500	171,777	(3,723)
Office equipment and supplies . .	686,464	718,500	202,324	(516,176)
Other expenses	201,000	35,700	42,449	6,749
Rent related expenses	23,000	25,000	24,098	(902)
Repair and maintenance	527,606	67,000	82,107	15,107
Special project	40,000	30,000	11,891	(18,109)
Education project	15,000			
Professional service	255,000	80,000	57,681	(22,319)
Utilities	123,200	80,100	71,104	(8,996)
Debt service payments	<u>532,071</u>	<u>400,000</u>	<u>6,966,768</u>	<u>6,566,768</u>
Total expenditures	<u>9,278,000</u>	<u>8,951,000</u>	<u>14,108,277</u>	<u>5,157,277</u>
Net change in fund balances				
- governmental funds	\$ -	\$ -	\$ (5,157,277)	\$ (5,157,277)

The Office of Government Ethics of the Commonwealth of Puerto Rico is not restricted of the use of funds nor has the need to ask approval from the Office of Management and Budget to change the use of programs funds assigned by Commonwealth of Puerto Rico.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

STATUTORY/BUDGETARY RECONCILIATION (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2019

Since accounting principles applied for purposes of developing data on a budgetary basis differ significantly from those used to present financial statements in conformity with accounting principles generally accepted in United States of America (GAAP), a reconciliation of the differences of revenues and expenditures between budgetary and GAAP presentation follows:

Sources/Inflows of Sources:

Actual amounts (budgetary basis) "available for appropriation" from the the budgetary comparison schedule	\$ 8,951,000
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Differences - Budget to GAAP

Revenues for which no budget was approved during current year	<u>79,542</u>
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Total revenues as reported on the statement of revenues, expenditures and changes in fund balance - governmental fund	<u>\$ 9,030,542</u>
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Uses Outflows of Resources:

Actual amounts (budgetary) basis "total charges to appropriations" from the budgetary comparison schedule	\$ 14,108,277
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Differences - Budget to GAAP	<u>-</u>
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Total expenditures as reported on the statement of revenues, expenditures and changes in fund balance - governmental fund	<u>\$ 14,108,277</u>
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OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
(A Component Unit of the Commonwealth of Puerto Rico)

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEAR ENDED JUNE 30, 2019

General Budgetary Policies and Procedures

The Office principal annual budget is the annual appropriation from the Commonwealth of Puerto Rico (the Commonwealth). The budget is prepared annually and submitted to the Legislature of the Commonwealth for approval.