COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND
HUMAN RESOURCES

BASIC FINANCIAL STATEMENTS
REQUIRED SUPPLEMENTARY INFORMATION
AND INDEPENDENT AUDITORS' REPORT
(WITH ADDITIONAL REPORTS AND INFORMATION
REQUIRED BY THE SINGLE AUDIT ACT)

Year Ended June 30, 2017

DEPARTAMENTO DEL
TRABAJO
Y RECURSOS HUMANOS
GOBIERNO DE PUERTO RICO

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES

BASIC FINANCIAL STATEMENTS, REQUIRED SUPPLEMENTARY INFORMATION AND INDEPENDENT AUDITORS' REPORT (WITH THE ADDITIONAL REPORTS REQUIRED BY THE SINGLE AUDIT ACT)

FOR THE YEAR ENDED JUNE 30, 2017

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López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

INDEPENDENT AUDITORS' REPORT

To the Honorable Secretary and Management of the
Commonwealth of Puerto Rico
Department of Labor and Human Resources
San Juan, Puerto Rico

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the **Department of Labor and Human Resources of the Commonwealth of Puerto Rico (the Department)**, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the **Department'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.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Vocational Rehabilitation Administration, which is an organizational component of the **Department** and represents 15.1%, 3.2% and 51.6%, respectively, of the assets, net position, and revenues of its governmental activities. Also, the Vocational Rehabilitation Administration is a major fund in the fund financial statements.

Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the funds indicated above, is based solely on the reports of the other auditors. 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 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 control. 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.

Calle Paraná #1686, El Cerezal, San Juan, P.R. 00926-3144 – Tel. (787) 777-8044 / Fax (787) 764-9377

INDEPENDENT AUDITORS' REPORT (CONTINUED)

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

Summary of Opinions:

Opinion Unit	Type of Opinion
Governmental Activities	Qualified
Business-type Activities	Qualified
General Fund	Qualified
Work Opportunity Incentive Fund	Qualified
Vocational Rehabilitation Administration Fund	Qualified GWFS Unmodified FFS
Unemployment Insurance Fund	Unmodified
Disability Insurance Fund	Qualified
Drivers' Insurance Fund	Qualified
Aggregate Remaining Fund Information	Qualified
Agency Fund	Unmodified

Basis for Qualified Opinions on Enterprise Funds and Business-Type Activities

The **Department** does not maintain adequate accounting records and reconciliation procedures for recording its financial transactions in the Disability Insurance Fund and Drivers' Insurance Fund areas of cash. Because of inadequacies in the **Department's** records we were unable to form an opinion regarding the aggregate amount of cash held by PR Secretary of Treasury amounting to $62.3 presented in the Statement of net Position (Business-type activities) and the Statement of Net Position – Enterprise Funds.

Qualified Opinions on Enterprise Funds and Business-Type Activities

In our opinion, based on our audit and the report of other auditors, except for the matters described in the "Basis for Qualified Opinions on Enterprise Funds and Business-Type Activities" paragraph, the financial statements referred to above present fairly, in all material respects, the financial statements referred to above present fairly, in all material respects, the financial position of the Enterprise Funds and the Business-type Activities of the **Department** as of June 30, 2017, and the respective changes in financial position or cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Basis for Qualified Opinions on Governmental Activities and Governmental Funds: General Fund, Work Opportunity Incentive Fund, the Vocational Rehabilitation Administration and Aggregate Remaining Fund Information"

As discussed in **Note 8** to the financial statements, management has not recorded certain general capital assets in the governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles generally accepted in the United States of America require that those assets be capitalized and depreciated, which would increase the assets, net position, and expenses of the governmental activities. The amount by which this departure would affect the assets, net position, and expenses of the governmental activities has not been determined.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Basis for Qualified Opinions on Governmental Activities and Governmental Funds: General Fund, Work Opportunity Incentive Fund and Aggregate Remaining Fund Information" (Continued)

As discussed in **Notes 1 and 11**, the Puerto Rico Employees Retirement System Administration (ERS) is the governmental agency that acts as administrator of the pension plan in which the employees of the Department participate. The ERS has not provided the audited actuarial and financial information necessary for the proper recognition and reporting of the **Department's** net pension liability as of June 30, 2017. As a result, management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68.

Accounting principles generally accepted in the United States of America require that governmental employers whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans recognize a liability and pension expense and report deferred outflows of resources and deferred inflows of resources related to pensions for its proportionate share of the collective net pension liability, pension expense, deferred outflows of resources and deferred inflows of resources reported by the pension plan trust. The amount by which this departure would affect the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the **Department's** governmental activities and the Vocational Rehabilitation Administration has not been determined.

In addition, the **Department's** financial statements do not disclose the descriptive information about the pension plans through which the pensions are provided required by the GASB Statement No. 68 for cost-sharing employers. In our opinion, disclosure of this information is required by accounting principles generally accepted in the United States of America.

The **Department** does not maintain adequate accounting records and reconciliation procedures for recording its financial transactions in the Governmental activities, General Fund, Work Opportunity Incentive Fund and Aggregate Remaining Fund Information in the areas of accounts payable. Because of inadequacies in the Department's records we were unable to form an opinion regarding the aggregate amount of accounts payable amounting to $197.9 presented in the accompanying Statement of Net Position and in the Balance Sheet-Governmental Funds in the General Fund, Work Opportunity Incentive Fund and the Aggregate Remaining Fund Information.

Qualified opinions on Governmental Activities and Governmental Funds: General Fund, Work Opportunity Incentive Fund and Aggregate Remaining Fund Information"

In our opinion, based on our audit and the report of other auditors, except for the matters described in the "Basis for Qualified Opinions on Governmental Activities and Governmental Funds: General Fund, Work Opportunity Incentive Fund, the Vocational Rehabilitation Administration and Aggregate Remaining Fund Information" paragraphs, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Governmental Activities, the General Fund, Work Opportunity Incentive Fund and Aggregate Remaining Fund Information of the **Department** as of June 30, 2017, and the respective changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Unmodified Opinions

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Vocational Rehabilitation Administration Fund and the Unemployment Insurance Fund and the Agency Fund of the **Department**, as of June 30, 2017, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in **Note 1**, the financial statements of the **Department**, are intended to present the financial position, the changes in financial position and, where applicable, cash flows of only that portion of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico that is attributable to the transactions of the Department.

They do not purport to, and do not, present fairly the financial position of the Commonwealth of Puerto Rico as of June 30, 2017, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

In addition, as described on **Note 2**, the Commonwealth of Puerto Rico and its instrumentalities are currently facing a severe fiscal and liquidity crisis. Continued operational deficits and lack of access to capital markets have resulted in delays in the repayment of loans outstanding by the Commonwealth and its instrumentalities with the Government Development Bank (GDB). This in turn has severely affected the GDB's liquidity position and the ability to repay its obligations. The liquidity crisis confronted by the Commonwealth and the GDB, have lead the management of both entities to determine that a substantial doubt exits as to the GDB's ability to continue as a going concern. As of June 30, 2017, the **Department's** held cash deposits on GDB accounts amounting to $82 million and $13.4 million recorded in the governmental and enterprise fund's financial statements, respectively, which are exposed to a significant custodial credit risk. Consequently, at that date an adjustment has been made on the **Department's** financial statements to recognize an impairment loss and reserve of $95.4 million on GDB deposits balances mentioned before.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages **7** through **21** and **80** through **82**, 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.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Other Matters (Continued)

Required Supplementary Information (Continued)

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 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.

Management has omitted historical pension information required as supplementary information related to new pension standards (GASB Statement No. 68) that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing 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. Our opinion on the basic financial statements is not affected by this missing information.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the **Department's** basic financial statements. The schedule of expenditures of federal awards is presented for purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Management, Cost Principles and Audit Requirement for Federal Awards*, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and is derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements.

Such 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated June 28, 2018, on our consideration of the **Department's** internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance.

INDEPENDENT AUDITORS' REPORT (CONTINUED)

Other Reporting Required by Government Auditing Standards (Continued)

That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering **Department's** internal control over financial reporting and compliance.

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
June 28, 2018

Stamp No. 2742180 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

The **Department of Labor and Human Resources of the Commonwealth of Puerto Rico (the Department)** provides this Management's Discussion and Analysis (MD&A) to the readers of the **Department's** basic financial statements. This MD&A provides a narrative overview and analysis of the financial activities of the **Department** as of and for the year ended June 30, 2017. The MD&A is designed to: (a) assist the reader in focusing on significant financial matters, (b) provide an overview of the **Department's** funds financial activities, and (c) highlight individual fund matters. Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, it should be read in conjunction with the **Department's** basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- The total assets of the **Department**, on a government-wide basis, exceeded its total liabilities by $397.1 million at the close of fiscal year 2017.

- Total assets of the **Department** amounted to $781.5 million, which represents an increase of $96.7 million, or 14.11%, when compared with the fiscal year 2016. Total liabilities of the **Department** amounted to $384.4 million, which represents an increase of $34.6 million, or 9.88%, when compared with the fiscal year 2016.

- The net position of the **Department** increased by $62.1 million, which represents an increase of 18.53%.

- Total operating revenues amounted to $348.6 million for the fiscal year ended June 30, 2017, showing a decrease of $17 million, or 4.66%, during the current fiscal year when compared to the prior fiscal year totals.

- Total operating expenses amounted to $300.8 million for the fiscal year ended June 2017, which represents a decrease of $41.6 million, or 12.16%, when compared to the fiscal year 2016.

- Total fund balances of governmental funds amounted to a deficit of $238.3 million at June 30, 2017, which represents an increase of $8.9 million, or 3.87%, in comparison with the fiscal year 2016.

- Total fund balances of the general fund amounted to a deficit of $66.3 million at June 30, 2017, reflecting an increase of $7.8 million, or 13.32%, when compared to the prior fiscal year.

The following table presents the Condensed Statements of Net Position of the **Department** as of June 30, 2017 and 2016, in thousands:

	Condensed Statements of Net Position					
	Governmental Activities		Business-type Activities		Total	
Description	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Current assets	$49,837	$12,673	$682,911	$639,211	$732,748	$651,884
Non-current assets	7,384	8,226	41,366	24,736	48,750	32,962
Total assets	$57,221	$20,899	$724,277	$663,947	$781,498	$684,846
Current liabilities	$296,941	$253,558	$73,520	$76,387	$370,461	$329,945
Non-current liabilities	13,047	18,780	915	1,128	13,962	19,908
Total liabilities	$309,988	$272,338	$74,435	$77,515	$384,423	$349,853
Net position:						
Net Investment in capital assets	$7,384	$8,226	$114	$192	$7,498	$8,418
Restricted for benefit payments	-	-	563,023	520,624	563,023	520,624
Unrestricted	(260,151)	(259,666)	86,705	65,617	(173,446)	(194,049)
Total net position	$(252,767)	$(251,440)	$649,842	$586,433	$397,075	$334,993

The following table presents the Condensed Statements of Activities of the **Department** for the years ended June 30, 2017 and 2016, in thousands:

	Condensed Statements of Activities					
	Governmental Activities		Business-type Activities		Total	
Description	**2017**	**2016**	**2017**	**2016**	**2017**	**2016**
Operating revenues	$118,294	$124,367	$230,283	$241,248	$348,577	$365,615
Operating expenses	164,818	188,613	135,938	153,792	300,756	342,405
Operating income (loss)	(46,524)	(64,246)	94,345	87,456	47,821	23,210
Non-operating revenues	101	54	14,608	11,971	14,709	12,025
Reserve for loss on deposits with Government Development Bank	(67)	(79,562)	(60)	(15,775)	(127)	(95,337)
Income (loss) before transfers	(46,490)	(143,754)	108,893	83,652	62,403	(60,102)
Transfers from (to) other funds	45,162	50,126	(45,483)	(50,126)	(321)	-
Net change in net position	(1,328)	(93,628)	63,410	33,526	62,082	(60,102)
Net position, beginning of year	(251,439)	(157,811)	586,432	552,906	334,993	395,095
Net position, ending	$(252,767)	$(251,439)	$649,842	$586,432	$397,075	$334,993

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This Management's Discussion and Analysis is required as supplementary information to the basic financial statements and is intended to serve as introduction to the basic financial statements of the **Department**. The **Department's** basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the basic financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves. These components are described below.

The **Department's** basic financial statements consist of two kinds of statements, each with a different view of the **Department's** finances. The government-wide financial statements provide both long-term and short-term information about the **Department's** overall financial status. The fund financial statements focus on major aspects of the **Department's** operations, reporting those operations in more detail than the government-wide financial statements.

Government-Wide Financial Statements: The government-wide financial statements are designed to provide users of the basic financial statements with a broad overview of the **Department's** finances in a manner similar to the private sector business. These statements present short and long-term information about the **Department's** financial position, which assists in assessing the **Department's** economic condition at the end of the year.

The Statement of Net Position provides information on the **Department's** assets and liabilities, with the difference between the two reported as net position. Over time, increases or decreases in the **Department's** net position may serve as a useful indicator of whether the financial position of the **Department** is improving or deteriorating as a result of the year's operations.

The Statement of Activities presents information on how the **Department's** net position changed during the reporting period. 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, the current year's revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

Both of the government-wide financial statements distinguish functions of the **Department** that are principally supported by intergovernmental revenues (governmental activities) from other functions that are intended to recover all or a significant portion of their costs through user fees or charges (business-type activities). The **Department's** governmental activities include general and administrative, employment regulations, employment services, occupational safety and health, rehabilitation services, statistics and monitoring, unemployment services, and work incentives. The business-type activities of the **Department** include unemployment insurance, disability insurance, drivers' insurance and the Vocational Rehabilitation Administration.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUED)

The Vocational Rehabilitation Administration functions, for all practical purposes, as an organizational component of the **Department** and, therefore, has been included as part of the governmental funds of the **Department**.

The government-wide financial statements of the **Department** can be found on pages 22 to 23 of this report.

Fund Financial Statements: A fund is a grouping of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The **Department**, like other state departments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. The **Department's** funds are divided in three categories: governmental funds, enterprise funds and agency funds.

Governmental funds: Governmental funds are 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, the governmental funds' financial statements focus on near-term inflows and outflows of expendable resources, as well as on balances of expendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds' Balance Sheet and the Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit), provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The **Department** maintains individual governmental funds. Information is presented in the governmental funds' Balance Sheet and in the Statement of Revenues, Expenditures, and Changes in Fund Balances (Deficit) for the General Fund, the Work Opportunity Incentive Fund, the Vocational Rehabilitation Administration and Other Governmental Funds, which are considered to be major funds of the **Department**. The governmental funds' financial statements of the **Department** provide separate information on the governmental activities of the Department's organizational component agencies.

The **Department's** basic governmental fund financial statements can be found on pages 24 to 27 of this report.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS (CONTINUED)

Enterprise funds: Enterprise funds are used to report the same functions presented as business-type activities in the government-wide financial statements and to provide the same type of information as the government-wide financial statements, only in more detail. The **Department** uses enterprise funds to account for the Unemployment Insurance, the Disability Insurance, the Drivers' Insurance and the Vocational Rehabilitation Administration Programs, which are all considered major funds.

The **Department's** basic enterprise funds' financial statements can be found on pages 28 to 30 of this report.

Agency fund: The agency fund is used to account for funds held in a purely custodial capacity. Since the agency fund should not be reported in the statement of changes in agency net position, such statement is not presented as a part of the basic financial statements. The **Department's** agency fund's financial statement of net position can be found on page 31 of this report.

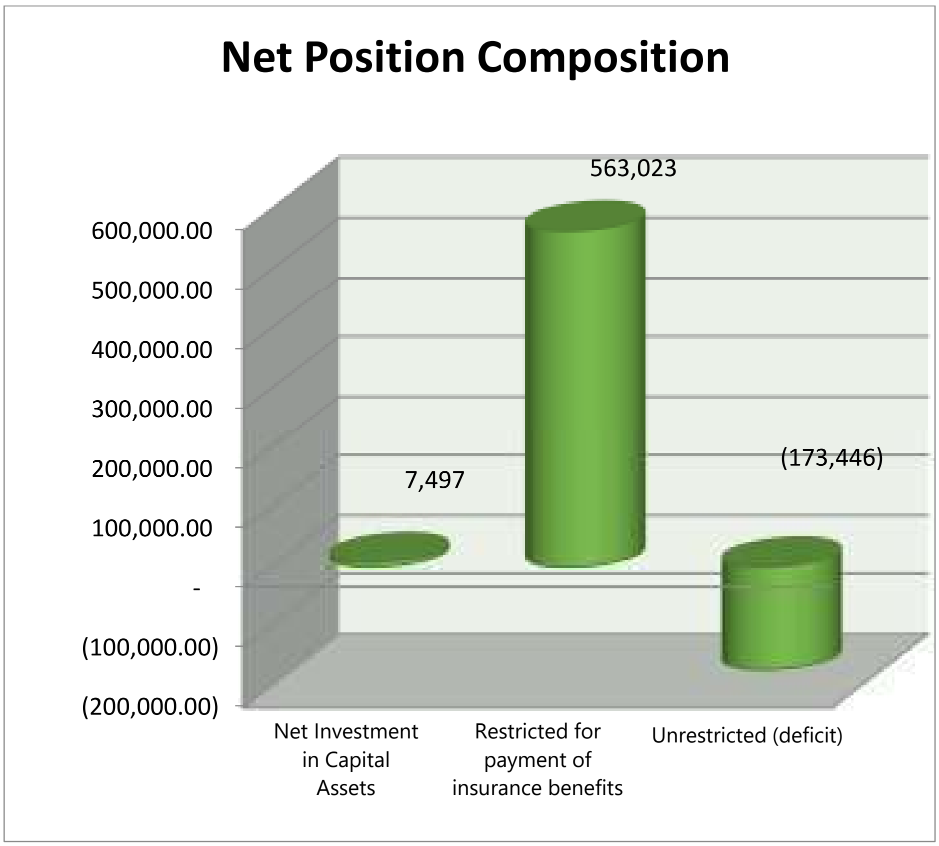
Notes to basic financial statements: The notes provide information that is essential for a full understanding of the data provided about the **Department**, which is included in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 32 through 79 of this report.

Other Information: The required supplementary information is included immediately following the notes to basic financial statements. This section includes the Budgetary Comparison Schedule - General Fund with the related Notes to Budgetary Comparison Schedule - General Fund and can be found on pages 80 through 82 of this report. A Budgetary Comparison Schedule has been provided for the general fund to demonstrate its compliance with the annual budget appropriations.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net Position

The net position serves over time as a useful indicator of the **Department's** financial position at the end of the fiscal year. Net position represents the residual interest in the **Department's** assets after liabilities are deducted. The **Department's** net position amounted to $397.1 million at June 30, 2017. The major classifications of the net position at June 30, 2017 are shown in the following illustration, in thousands:



A portion of the **Department's** net position reflects its investment in capital assets such as buildings, furniture and equipment, computer equipment and software, and vehicles. The **Department** uses these capital assets to provide services to eligible citizens; consequentially, these assets are not available for future spending.

An additional portion of the **Department's** net position represents resources that are subject to external restrictions on how they may be used. An otherwise positive remaining balance would be used to meet the **Department** ongoing obligations for eligible citizens' claims and creditors. Internally imposed designations of resources are not presented as restricted net position.

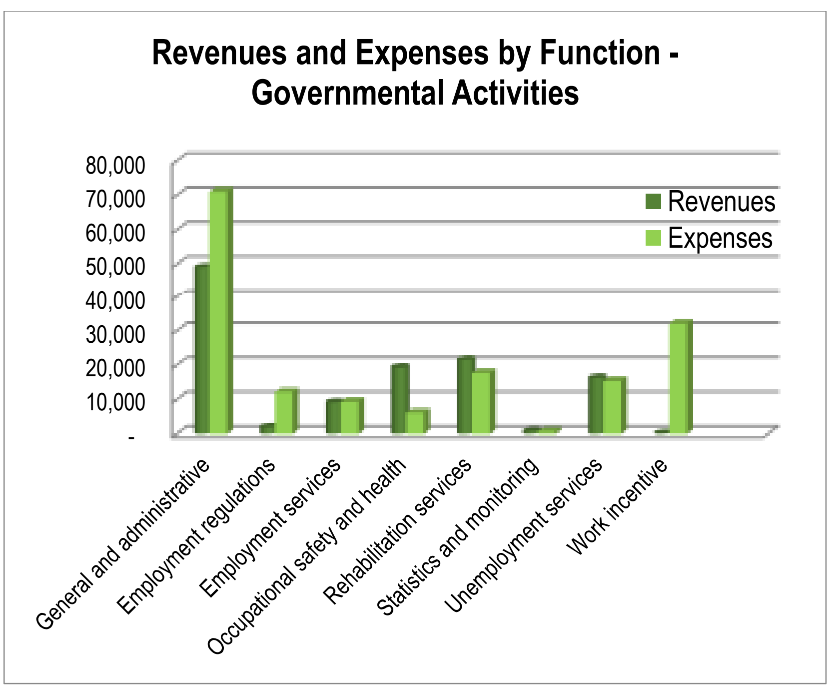
GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Changes in Net position

The **Department's** net position increased by $62.1 million during the fiscal year 2017 when compared to 2016. The change in net position is composed of a negative change in net position of $1.3 million from governmental activities and a positive change in net position of $63.4 million from business-type activities.

Governmental Activities

Governmental activities expenses exceeded revenues by $46.5 million resulting in transfers from business-type activities of $45.2 million. Operating grants and contributions assigned to governmental activities represent approximately 32.6% of the total revenues of the **Department**. The **Department's** governmental activities' major sources of revenues are accounted for as general and administrative, unemployment services, occupational safety and health, and rehabilitation services functions. Those revenues represent 89.80% of the total governmental activities revenues for the year ended June 30, 2017. In comparison with the fiscal year 2016, revenues from the governmental activities of the **Department** decreased by $6.0 million. The largest expenses in 2017 were general and administrative and work incentive services, which accounted for 62.61% of total governmental activities' expenses. In comparison with the fiscal year 2016, total expenses from governmental activities of the **Department** decreased by $23.8 million. The following chart presents the revenue and expenses comparison by function of the governmental activities for the year ended June 30, 2017 (in thousand):



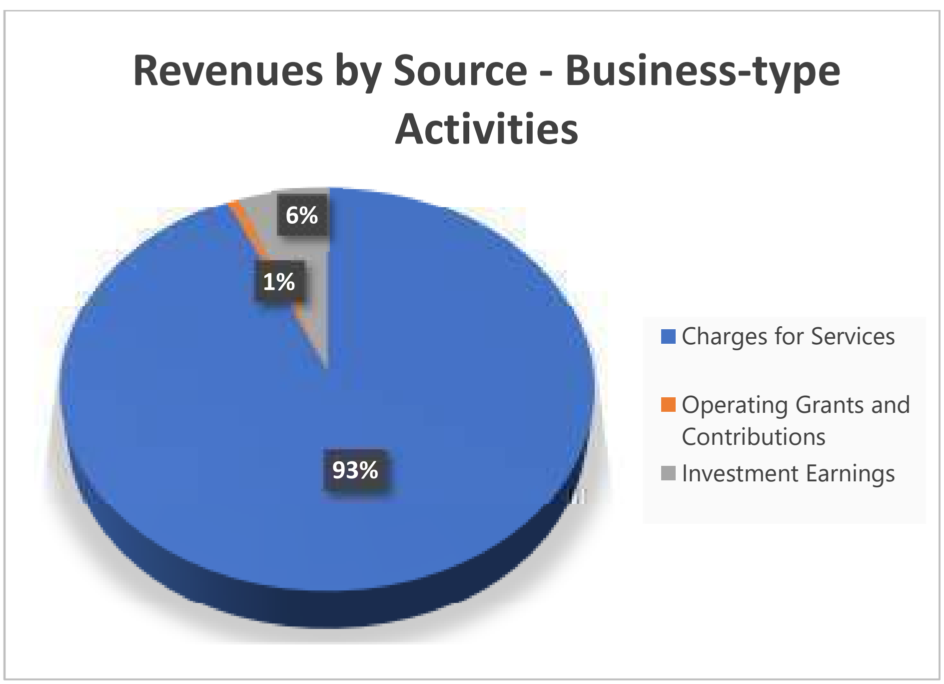
GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

Business-type Activities

The Department's major sources of revenues are derived from the business-type activities, which represent 67.41% and 67.05% of total revenues from all sources for the years ended June 30, 2017 and 2016, respectively. Operating grants and contributions presented a decrease of $330.3 thousand when compared with the fiscal year 2016. This change was mainly due to reductions in unemployment federal grants received during the year 2017. Charges for services, consisting mainly of insurance premiums, presented a decrease of $10.64 million when compared with the fiscal year 2016, representing a decrease of 4.45%. This change is due to a decrease in the insurance premiums collected from Unemployment Insurance as a result of the economic recession experienced in Puerto Rico since 2006. Such recession has been resulted in increases in bankruptcy cases and business closings.

During the fiscal year ended June 30, 2017, the **Department** also earned net investment income amounting to $14.6 million from different financial institutions. Interest income derived from the Unemployment Insurance Program amounted to $11.6 million, representing 79.13% of total investment income earned during the year.

The following chart presents revenues by source of the business-type activities for the year ended June 30, 2017:



GOVERNMENT-WIDE FINANCIAL ANALYSIS (CONTINUED)

During the year 2017, the **Department** incurred expenses for the business-type activities amounting to $135.9 million related to benefits of unemployment insurance, temporary non-occupational disability insurance, drivers' insurance and Vocational Rehabilitation Administration programs claimed by eligible citizens. Total expenses decreased by $17.9 million when compared with the prior year expenses, resulting in a decrease of 11.61%. This change was directly related to a reduction in the unemployment claims due to: (1) an increase in the migration trend that the Island has experienced during the previous years, and (2) to an increased oversight of the employment status of the beneficiaries.

Moreover, during fiscal year 2017, revenues from business-type activities exceeded expenses by $108.9 million.

FINANCIAL ANALYSIS OF THE DEPARTMENT'S FUNDS

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

Governmental Funds:

The focus of the **Department's** governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing the **Department's** financing requirements. In particular, unassigned fund balance may serve as a useful measure of the government's net resources available for spending at the end of the fiscal year. Total expenditures of the governmental funds exceeded total revenues by $54.04 million. This was offset by other financing sources, mainly transfers of funds amounting to $45.2 million from the enterprise funds for operational purposes. This year, the excess of expenditures over revenues decreased by $90.5 million (62.62%) when compared with the prior fiscal year.

As of the end of the fiscal year 2017, the **Department's** governmental funds reported a combined ending fund deficit amounting to $238.3 million. Of this amount, $17.8 thousand are restricted or assigned, meaning that funds are not available for new spending because they have already been committed: (1) to liquidate contracts and purchase orders of the prior fiscal year or (2) for a variety of other restricted purposes.

The general fund is the main operating fund of the **Department**. At the end of the current fiscal year, the fund deficit of the general fund was $66.3 million.

The fund deficit of the **Department's** general fund increased by $7.8 million. This represents a 13.32% increase when compared to the general fund's deficit reported in the fiscal year 2016.

Enterprise Funds

The enterprise funds' financial statements provide the same type of information as the government-wide financial statements' business-type activities, only in more detail. As discussed in the government-wide financial analysis above, the **Department's** business-type activities net position, increased by $63.4 million. This is mainly due to an increase in net position of $55.9 million in the unemployment insurance fund. The following are some of the most important financial highlights of the enterprise funds' financial statements:

- The Department's enterprise funds reported combined ending net position of $649.8 million at the end of current year.
- Total operating revenues of the enterprise funds exceeded total operating expenses for a net operating income of $92.4 million.
- Total benefits paid by the enterprise funds to eligible citizens during the year ended June 30, 2017 amounted to $124.9 million.

Agency Fund

At June 30, 2017, the **Department's** agency fund has cash available of $13.2 million to pay for unsettled claims between employers and employees. It represents an increase of $4.2 million in the agency fund when compared to the fiscal year 2016.

GENERAL FUND BUDGETARY HIGHLIGHTS

The General Funds' final budget for the fiscal year ended June 30, 2017 was $28.4 million and the actual expenditures were $27.1 million. The total budget availability exceeded the total expenditures by 4.6% for the fiscal year.

The following table summarizes the budget and actual expenditures in budgetary basis for fiscal years ended June 30, 2017 and 2016, in thousands:

	2017 Original Budget	2016 Original Budget	Original Budget Change	2017 Final Budget	2016 Final Budget	Final Budget Change	Original & Final Budget Change Between 2017 & 2016	2017 Actual Amounts in Budgetary Basis	2016 Actual Amounts in Budgetary Basis	Actual Amounts Change
Revenues	$28,560	$25,171	$3,389	$28,407	$25,776	$2,631	$758	$28,407	$25,776	$2,631
Expenditures	28,560	25,171	3,389	28,407	25,776	2,631	758	27,149	25,602	1,547
Unexpended (Overexpended Balance)	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$1,258	$174	$1,084

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

The capital assets of the **Department** are those assets that are used in the performance of its functions. The investment in capital assets (net of accumulated depreciation) as of June 30, 2017 amounted to a net book value of $7.5 million. Total capital assets additions for the year amounted to $123 thousand while depreciation expense for the year totaled $1.04 million. The following table summarizes capital assets, net of accumulated depreciation, for both governmental and business-type activities for the fiscal years ended June 30, 2017 and 2016, in thousands:

	2017	2016	Change
Governmental Activities:			
Buildings	$5,965	$6,216	$(251)
Furniture and equipment	1,419	2,004	(585)
Vehicles	-	6	(6)
	7,384	8,226	(842)
Business-type Activities:			
Buildings	93	136	(43)
Furniture and equipment	17	28	(11)
Vehicles	3	27	(24)
	113	191	(78)
Total capital assets	**$7,497**	**$8,417**	**$(920)**

Long-term Debt

The **Department's** long-term liabilities decreased by $8.7 million when compared to the fiscal year 2016, (27.1%). The following table summarizes the long-term debt for both governmental and business-type activities for the fiscal years ended June 30, 2017 and 2016, in thousands:

	2017	2016	Change
Governmental Activities:			
Compensated absences	$15,745	$22,871	$(7,126)
Christmas bonus	861	1,365	(504)
Early retirement program	5,226	5,985	(759)
	21,832	30,221	(8,389)
Business-type Activities:			
Compensated absences	1,546	1,854	(308)
Total Governmental & Business-Type Activities	$23,378	$32,075	$(8,697)

ADOPTION OF GASB STATEMENT NO. 68

The GASB Statement No. 68, *"Accounting and Financial Reporting for Pensions, an amendment to GASB Statement No. 27"*, was effective for the fiscal year ended June 30, 2016. This Statement requires participants of cost-sharing defined benefit pension plans that are administered through trusts that comply with certain criteria to recognize in their financial statements their proportionate share of the collective net pension liability, net pension expense and deferred outflows/inflows of resources related to pensions. The **Department's** pension plan is administered by the Employees Retirement System Administration (ESR). The ESR has not issued its audited financial statements for the fiscal year ended June 30, 2016 (the plan's measurement date), and as a result, the **Department** could not comply with the accounting and financial reporting requirements set forth in GASB Statement No. 68. Consequently, the **Department's** financial statements do not report or disclose the required information for its pension plan liability for the fiscal year 2016-17.

ECONOMIC FACTORS

As mentioned before, the Commonwealth of Puerto Rico (the Commonwealth) and its instrumentalities are currently facing a severe fiscal and liquidity crisis. This is the culmination of many years of significant governmental deficits, a prolonged economic recession (which commenced in 2006), high unemployment rate, population decline, and high levels of debt and pension obligations. Also, credit rating agencies have been downgrading the Commonwealth's debt obligations ratings based on, among other problems, years of deficit financing, pension underfunding, budgetary imbalance, and as mentioned before, years of prolonged recession.

As more fully explained in **Notes 14** and **16** to the financial statements, the Government of the United States of America and the Commonwealth have approved and implemented certain laws to overcome this crisis. Following are some of the measurements implemented to this end:

- **Puerto Rico Fiscal Agency and Financial Advisory Authority – Act No. 2 of 2017**

  On January 18, 2017, the Commonwealth of Puerto Rico approved Act No. 2, known as "The Puerto Rico Fiscal Agency and Advisory Authority (FAFAA)" in order to empower the Authority to oversee compliance with the certified budget and fiscal plan approved pursuant to the Puerto Rico Oversight, Management and Economic Stability Act of 2016 (PROMESA); to delegate to the Authority the power to revise matters including, but not limited to, agreements, transactions and regulations of the agencies and instrumentalities of the Government of Puerto Rico; to provide that it shall be the only entity authorized to enter into creditors' agreements, and/or renegotiate or restructure the public debt, in whole or in part, or any other debt issued by any Government body including, but not limited to, agencies, boards, commissions, instrumentalities, public corporations or applicable political subdivision; to provide that the Executive Director of the FAFAA shall be the legal successor of the President of the Government Development Bank for Puerto Rico (GDB) in every board, committee, commission or Council; to repeal Chapter 6 of Act No. 21-2016, as amended, and the Puerto Rico Fiscal Oversight and Recovery Organic Act, Act No. 208-2015; and for other related purposes.

- **Puerto Rico Financial Emergency and Fiscal Responsibility Act – Act No. 5 of 2017**

  On January 29, 2017, the Commonwealth of Puerto Rico approved Act No. 5, known as "Puerto Rico Financial Emergency and Fiscal Responsibility Act" to facilitate and encourage a voluntary negotiation process under PROMESA between the Governor and/or the FAFAA, on behalf of the Government of Puerto Rico, and the creditors of the Government of Puerto Rico and its instrumentalities. This Act Authorizes the Government of Puerto Rico, within the parameters established by PROMESA, to designate certain services necessary for the health, safety and welfare of the residents of Puerto Rico and provided by the Government of Puerto Rico and its instrumentalities as "essential services", in accordance with the Constitution of Puerto Rico.

- **Fiscal Plan Submissions and Certifications – Commonwealth of Puerto Rico and Government Development Bank for Puerto Rico**

  On a letter dated January 18, 2017, the Financial Oversight and Management Board of Puerto Rico ("the Board") provided the Governor the fiscal plan targets and guidelines, on a category-by-category basis, that the certified plan should satisfy. Also, the Board approved the Governor's request that it extend the PROMESA stay on litigation through May 1, 2017 on conditions agreed to by the Governor, including a commitment not to attempt to procure short-term liquidity loans that could restrict fiscal options.

  On February 28, 2017, the Governor submitted a proposed fiscal plan and, after the review, analysis and deliberation with the Board's members, economists, consultants, attorneys and Governor's representatives, the Board informed the Governor on March 9, 2017 that it had determined the proposed fiscal plan did not satisfy PROMESA's requirements. On March 11, 2017, the Governor submitted to the Board a revised fiscal plan. On March 13, 2017, the Board approved and certified this final plan.

- **Filing of Title III of PROMESA for the District of Puerto Rico**

  On May 3, 2017, the Financial Oversight and Management Board for Puerto Rico approved and certified the filing in the United States District Court for the District of Puerto Rico of a voluntary petition under Title III of PROMESA for the Commonwealth of Puerto Rico. This filling was necessary due to the expiration on May 1, 2017 of the stay against litigation provided by PROMESA, and thus making the government vulnerable to lawsuits by its creditors. The voluntary filing under Title III would preclude those lawsuits while allowing the possibility of consensual negotiations to continue. Also, on May 5, 2017, another voluntary petition under Title III of PROMESA was approved, certified and filed for the Puerto Rico Sales Tax Financing Corporation ("COFINA") and, on May 22, 2017, the Board approved, certified and filed similar voluntary petitions for the Puerto Rico Highway and Transportation Authority ("HTA") and the Government of Puerto Rico Employees Retirement System ("ERS"). Also, on July 1, 2017, the members of the Oversight Board of PROMESA unanimously authorized the Puerto Rico Power Authority (PREPA) to file bankruptcy under the provisions of Title III of PROMESA. Accordingly, on July 2, 2017, PREPA filed bankruptcy in the United States District Court of Puerto Rico.

- **Law No. 122 – Law of the New Government of Puerto Rico**

  Law No. 122 of December 18, 2017 was enacted to create the "New Puerto Rico Government Law", in order to empower the Governor of Puerto Rico to maximize the resources and personnel of the Executive Branch through the transfer, consolidation, reorganization, outsourcing and creation of new and more efficient structures governments and agencies through an agile process with Reorganization Plans which will be reviewed by the Legislative Assembly for approval or rejection; authorize the Governor to reorganize, outsource and consolidate, agencies, programs and services of the Executive Branch through Reorganization Plans which will be reviewed and approved by the Legislative Assembly according to the procedure described in this Law; arrange the powers and faculties of the heads of the agencies; repeal Law 182-2009, known as the "Law of Reorganization and Modernization of the Executive Branch 2009"; repeal Law 5-1993; and for other related purposes.

- **Law No. 8 – Administration and Transformation of the Human Resources "Single Employer Law"**

  On February 4, 2017, the Government enacted Law No. 8 for the Administration and Transformation of the Human Resources of the Government of Puerto Rico. Effective on that date, this Law establishe and recognized that the government as a Single Employer. As described on **Note 1**, under the provisions of this Law certain employee benefits were reduced.

- **Hurricanes Irma (DR-4336) and María (DR-4339)**

  During the month of September 2017, Puerto Rico suffered the passing of Hurricane Irma and María, causing catastrophic damages to the infrastructure and the collapsing of the electric power grid and the telecommunications system of the entire Island. The Island was declared a major disaster area by the President of the United States on September 20, 2017 and approximately $508 million dollars in public assistance grants have been obligated. Many citizens lost their homes and the business sector suffered substantial losses due to infrastructure damages, looting during and after the hurricanes, loss of inventory and the absence of electric power, which forced businesses to invest in power generators to operate, incurring in significant gasoline and diesel expenses.

  The Commonwealth of Puerto Rico and the Financial Oversight and Management Board are working with the Federal Emergency Management Agency (FEMA) on the recovery of the Island, but the recuperation efforts have taken several months in order to bring back a certain level of normalcy to the everyday life of Puerto Rico's citizens. The U.S. President and Congress have been working on the assignment of federal assistance of approximately $94 million, mainly for the reconstruction of the electric infrastructure and housing assistance for the residents of Puerto Rico.

NEXT YEAR'S BUDGET

The **Department's** budget for the fiscal year 2018, adopted at July 1, 2018, amounts to approximately $186.2 million. The legislative appropriations amount to $21.8 million for the fiscal year 2018.

REQUESTS FOR INFORMATION

This report is designed to provide a general overview of the **Department's** finances and to demonstrate the accountability of the funds administered by the **Department**. For questions regarding the information provided or additional financial information requests please, contact the Assistant Secretary of Management Affairs of the **Department of Labor and Human Resources**, P.O. Box 195540, San Juan, Puerto Rico 00919-5540.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Net Position
June 30, 2017

	Governmental Activities	Business-type Activities	Total
ASSETS:			
Cash and cash equivalents in commercial banks	$ 40,709,117	$ 517,766	$ 41,226,883
Cash and cash equivalents in governmental banks	696,574	254,647	951,221
Cash held by PR Secretary of Treasury	-	62,333,105	62,333,105
Accounts receivable:			
Insurance premiums, net	-	3,921,481	3,921,481
Accrued insurance interest	-	35,700	35,700
Accrued investment interest	-	166,693	166,693
Due from federal government	9,685,233	-	9,685,233
Other receivables	241,547	-	241,547
Inventories	-	153,566	153,566
Prepaid expenses	120,078	69,397	189,475
Internal balances	(1,847,328)	1,847,328	-
Restricted assets:			
Cash and cash equivalents in commercial banks	-	1,898,708	1,898,708
Cash and cash equivalents in governmental banks	231,820	33,354	265,174
Cash held by PR Secretary of Treasury	-	557,540,006	557,540,006
Insurance premiums, net	-	53,252,769	53,252,769
Other receivables	-	886,326	886,326
Note receivable from Commonwealth	-	15,000,000	15,000,000
Investments	-	26,252,554	26,252,554
Capital assets, net of accumulated depreciation	7,383,925	113,587	7,497,512
TOTAL ASSETS	57,220,966	724,276,987	781,497,953
LIABILITIES:			
Accounts payable and accrued liabilities	271,911,302	1,788,403	273,699,705
Unearned revenue	2,287,325	21,018,321	23,305,646
Due to other governmental entities	13,943,753	6,317	13,950,070
Insurance benefits payable	-	50,075,885	50,075,885
Contract retainage payable	13,032	-	13,032
Other liabilities	228	-	228
Long-term liabilities:			
Due within one year	8,785,892	631,394	9,417,286
Due in more than one year	13,046,507	915,041	13,961,548
TOTAL LIABILITIES	309,988,039	74,435,361	384,423,400
NET POSITION (DEFICIT):			
Net Investment in capital assets	7,383,925	113,587	7,497,512
Restricted for payment of insurance benefits	-	563,023,241	563,023,241
Unrestricted (deficit)	(260,150,998)	86,704,798	(173,446,200)
TOTAL NET POSITION (DEFICIT)	$ (252,767,073)	$ 649,841,626	$ 397,074,553

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Activities
For the Year Ended June 30, 2017

		Program Revenues		Net Revenues (Expenses) and Changes in Net Position		
	Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-type Activities	Net (Expenses) Revenues
Functions/Programs:						
Governmental Activities:						
General and administrative	$ 71,099,331	$ -	$ 49,109,632	$ (21,989,699)	$ -	$ (21,989,699)
Employment regulations	12,152,890	-	2,014,560	(10,138,330)	-	(10,138,330)
Employment services	9,430,980	-	9,146,145	(284,835)	-	(284,835)
Occupational safety and health	6,184,638	-	19,320,307	13,135,669	-	13,135,669
Rehabilitation services	17,731,366	-	21,556,692	3,825,326	-	3,825,326
Statistics and monitoring	718,008	-	760,876	42,868	-	42,868
Unemployment services	15,413,819	-	16,244,496	830,677	-	830,677
Work incentive	32,086,964	-	140,952	(31,946,012)	-	(31,946,012)
Total governmental activities	164,817,996	-	118,293,660	(46,524,336)	-	(46,524,336)
Business-type Activities:						
Unemployment Insurance	122,641,845	209,501,535	1,394,674	-	88,254,364	88,254,364
Disability Insurance	8,382,250	14,261,009	-	-	5,878,759	5,878,759
Driver's Insurance	4,152,024	4,401,575	-	-	249,551	249,551
Vocational Rehabilitation Administration	761,776	257,018	467,000	-	(37,758)	(37,758)
Total business-type activities	135,937,895	228,421,137	1,861,674	-	94,344,916	94,344,916
Total	$ 300,755,891	$ 228,421,137	$ 120,155,334	$ (46,524,336)	$ 94,344,916	$ 47,820,580

	Governmental Activities	Business-type Activities	Net (Expenses) Revenues
General Revenues:			
Unrestricted investment earnings	$ 101,223	$ 14,607,821	$ 14,709,044
Reserve for loss on deposits with the Government Development Bank	(67,264)	(60,016)	(127,280)
Transfers	45,162,393	(45,483,372)	(320,979)
Total general revenues and transfers	45,196,352	(30,935,567)	14,260,785
CHANGES IN NET POSITION	(1,327,984)	63,409,349	62,081,365
NET POSITION (DEFICIT) - beginning of year	(251,439,089)	586,432,277	334,993,188
NET POSITION (DEFICIT) - end of year	$ (252,767,073)	$ 649,841,626	$ 397,074,553

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Balance Sheet - Governmental Funds
June 30, 2017

	General Fund	Work Opportunity Incentive Fund	Vocational Rehabilitation Administration	Other Governmental Funds	Total Governmental Funds
ASSETS:					
Cash and cash equivalents in commercial banks	$ 7,308,416	$ 33,399,601	$ -	$ 1,100	$ 40,709,117
Cash and cash equivalents in governmental banks	-	-	696,574	-	696,574
Cash held by PR Secretary of Treasury	-	-	231,820	-	231,820
Due from:					
Federal government	-	-	6,590,602	3,094,631	9,685,233
Other funds	439,536	6,602,311	144,893	104,975	7,291,715
Other receivables	-	6,036	155,691	79,820	241,547
Prepaid expenses	-	-	120,078	-	120,078
TOTAL ASSETS	7,747,952	40,007,948	7,939,658	3,280,526	58,976,084
LIABILITIES AND FUND BALANCES (DEFICIT)					
LIABILITIES:					
Accounts payable	60,203,126	205,960,591	3,143,855	2,603,730	271,911,302
Due to other funds	7,078,794	2,060,249	-	-	9,139,043
Unearned revenues	-	1,580,171	-	707,154	2,287,325
Due to other governmental entities	6,751,020	2,457,472	4,765,848	(30,587)	13,943,753
Contract retainage payable	-	-	13,032	-	13,032
Other liabilities	-	-	-	229	229
Total liabilities	74,032,940	212,058,483	7,922,735	3,280,526	297,294,684
FUND BALANCES (DEFICITS):					
Restricted	-	-	17,788	-	17,788
Unassigned	(66,284,988)	(172,050,535)	(865)	-	(238,336,388)
Total fund balances (deficits)	(66,284,988)	(172,050,535)	16,923	-	(238,318,600)
TOTAL LIABILITIES AND FUND BALANCES (DEFICIT)	$ 7,747,952	$ 40,007,948	$ 7,939,658	$ 3,280,526	$ 58,976,084

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Position
June 30, 2017

Total fund deficit per Balance Sheet - Governmental Funds		$ (238,318,600)
Amounts reported for governmental activities in the Statement of Net position are different than the amount reported in the Balance Sheet - Governmental Funds because:		
Capital assets used in governmental activities are not financial resources and, therefore, not recognized in the Balance Sheet - Governmental Funds:		
Depreciable capital assets	$ 25,100,953	
Accumulated depreciation	(17,717,027)	
Total capital assets		7,383,926
Some of the Department's liabilities are not due and payable in the current period and, therefore, are not recorded in the funds. Those liabilities consist of:		
Compensated absences	(15,745,221)	
Termination benefits	(5,226,214)	
Christmas bonus	(860,964)	
Total		(21,832,399)
Total Net Position of Governmental Activities		$ (252,767,073)

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Revenues, Expenditures and
Changes in Fund Balances (Deficit) - Governmental Funds
For the Year Ended June 30, 2017

	General Fund	Work Opportunity Incentive Fund	Vocational Rehabilitation Administration	Other Governmental Funds	Total Governmental Funds
REVENUES:					
Legislative appropriations	$ 10,295,058	$ -	$ 14,568,420	$ -	$ 24,863,478
Special appropriations	-	-	600,000	-	600,000
Intergovernmental federal grants	-	-	45,869,472	27,419,128	73,288,600
Donations from other governmental entities	19,430,071	-	-	-	19,430,071
Interest	3,442	97,781	-	-	101,223
Impairment loss on deposits with the Government Development Bank	(17,808)	(49,456)	-	-	(67,264)
Other	27,664	63,916	19,931	-	111,511
Total revenues	29,738,427	112,241	61,057,823	27,419,128	118,327,619
EXPENDITURES:					
General and administrative	34,766,444	-	37,768,326	75,925	72,610,695
Employment regulations	12,661,815	-	-	-	12,661,815
Employment services	1,457,792	-	-	7,628,823	9,086,615
Occupational safety and health	5,203,252	-	-	1,598,955	6,802,207
Rehabilitation services	-	-	23,465,841	-	23,465,841
Statistics and monitoring	-	-	-	718,008	718,008
Unemployment services	-	-	-	15,403,630	15,403,630
Work incentive	-	31,551,339	-	64,385	31,615,724
Total expenditures	54,089,303	31,551,339	61,234,167	25,489,726	172,364,535
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(24,350,876)	(31,439,098)	(176,344)	1,929,402	(54,036,916)
OTHER FINANCING SOURCES (USES):					
Transfers in	17,306,979	42,824,434	-	-	60,131,413
Transfers out	(750,000)	(12,197,689)	(91,929)	(1,929,402)	(14,969,020)
Total other financing sources (uses)	16,556,979	30,626,745	(91,929)	(1,929,402)	45,162,393
NET CHANGE IN FUND BALANCES (DEFICIT)	(7,793,897)	(812,353)	(268,273)	-	(8,874,523)
FUND BALANCES (DEFICIT) - Beginning of Year	(58,491,091)	(171,238,182)	285,196	-	(229,444,077)
FUND BALANCES (DEFICIT) - End of year	$ (66,284,988)	$ (172,050,535)	$ 16,923	$ -	$ (238,318,600)

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balance (Deficit) of Governmental Funds to the Statement of Activities

For the Year Ended June 30, 2017

Net Change in Fund Deficit - Governmental Funds		$ (8,874,523)
Amounts reported for governmental activities in the Statement of Activities and changes in net position are different because:		
Governmental funds report capital outlays as expenditures. However, in the Statement of Activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. In the current period, these amounts are:		
Capital outlays	$ 116,829	
Depreciation expense	(959,348)	
Excess of depreciation expense over capital outlays		(842,519)
Some expenses reported in the Statement of Activities do not require the use of current financial resources and, therefore, are not recorded as expenditures. Those activities consist of:		
Christmas bonus – net change	504,187	
Compensated absences – net change	7,125,464	
Termination benefits – net change	759,407	
Total additional expenses		8,389,058
Change in Net Position of Governmental Activities		$ (1,327,984)

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES

Statement of Net Position - Enterprise Funds

June 30, 2017

	Business-type Activities				
	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Vocational Rehabilitation Administration	Total Enterprise Funds
ASSETS					
Current Assets:					
Cash and cash equivalents in commercial banks	$ -	$ 517,766	$ -	$ -	$ 517,766
Cash and cash equivalents in commercial banks-restricted	1,659,179	239,529	-	-	1,898,708
Cash and cash equivalents in governmental bank	-	-	-	254,647	254,647
Cash held by PR Secretary of Treasury	18,824	52,462,942	9,851,339	-	62,333,105
Cash held by US Treasury Department-restricted	557,540,006	-	-	-	557,540,006
Receivables, net					
Insurance premiums	53,252,769	2,911,142	1,010,339	-	57,174,250
Accrued insurance interest	-	35,700	-	-	35,700
Accrued investment interest	-	166,693	-	-	166,693
Other	43,420	750,000	-	92,906	886,326
Inventories	-	-	-	153,566	153,566
Prepaid merchandise	-	-	-	69,397	69,397
Total current assets	612,514,198	57,083,772	10,861,678	570,516	681,030,164
Noncurrent Assets:					
Restricted cash held by PR Secretary of Treasury	-	-	-	33,354	33,354
Due from other funds	-	-	9,139,043	-	9,139,043
Restricted investments	-	26,252,554	-	-	26,252,554
Notes receivable from Commonwealth government	-	15,000,000	-	-	15,000,000
Capital assets, net of accumulated depreciation	-	4,617	-	108,970	113,587
TOTAL ASSETS	$ 612,514,198	$ 98,340,943	$ 20,000,721	$ 712,840	$ 731,568,702
LIABILITIES AND NET POSITION					
Current Liabilities:					
Accounts payable	$ -	$ 1,174,744	$ 460,011	$ 153,648	$ 1,788,403
Due to other funds	7,146,822	-	-	144,893	7,291,715
Unearned revenue	19,405,026	1,598,898	14,397	-	21,018,321
Due to other governmental entities	-	1,168	5,149	-	6,317
Compensated absences, current portion	-	384,976	224,400	22,018	631,394
Insurance benefits payable	49,431,192	543,718	100,975	-	50,075,885
Total current liabilities	75,983,040	3,703,504	804,932	320,559	80,812,035
Noncurrent Liabilities:					
Compensated absences	-	577,463	336,601	977	915,041
TOTAL LIABILITIES	75,983,040	4,280,967	1,141,533	321,536	81,727,076
Net Position:					
Net investment in capital assets	-	4,617	-	108,970	113,587
Restricted for payment of insurance benefits	536,531,158	26,492,083	-	-	563,023,241
Unrestricted	-	67,563,276	18,859,188	282,334	86,704,798
TOTAL NET POSITION	$ 536,531,158	$ 94,059,976	$ 18,859,188	$ 391,304	$ 649,841,626

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Revenues, Expenses and Changes in Net Position - Enterprise Funds
For the Year Ended June 30, 2017

	Business-type Activities				
	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Vocational Rehabilitation Administration	Total Enterprise Funds
OPERATING REVENUES					
Insurance premiums	$ 209,501,535	$ 14,261,009	$ 4,401,575	$ -	$ 228,164,119
Net sales	-	-	-	257,018	257,018
Total operating revenues	209,501,535	14,261,009	4,401,575	257,018	228,421,137
COST OF SALES					
Materials, direct labor, indirect costs	-	-	-	447,805	447,805
Total cost of sales	-	-	-	447,805	447,805
EXCESS OF COST OF SALES OVER OPERATING REVENUES	-	-	-	(190,787)	(190,787)
OPERATING EXPENSES:					
Insurance benefits	122,641,845	1,579,783	655,636	-	124,877,264
General and administrative expenses	-	6,802,467	3,496,388	313,973	10,612,828
Total operating expenses	122,641,845	8,382,250	4,152,024	313,973	135,490,092
OPERATING INCOME (LOSS)	86,859,690	5,878,759	249,551	(504,760)	92,483,240
NONOPERATING REVENUES (EXPENSES):					
Contributions from federal government	1,394,674	-	-	-	1,394,674
Impairment loss on deposits on the Government Development Bank	(47,016)	-	(13,000)	-	(60,016)
Interest and investment earnings	11,558,646	2,843,791	205,384	-	14,607,821
Appropriations from central government	-	-	-	467,000	467,000
Total nonoperating revenues	12,906,304	2,843,791	192,384	467,000	16,409,479
INCOME (LOSS) BEFORE TRANSFERS	99,765,994	8,722,550	441,935	(37,760)	108,892,719
TRANSFERS OUT	(43,854,322)	(1,400,000)	-	(229,050)	(45,483,372)
NET CHANGE IN NET POSITION	55,911,672	7,322,550	441,935	(266,810)	63,409,347
NET POSITION - Beginning of year	480,619,486	86,737,426	18,417,253	658,114	586,432,279
NET POSITION - End of year	$ 536,531,158	$ 94,059,976	$18,859,188	$ 391,304	$ 649,841,626

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
Statement of Cash Flows - Enterprise Funds
For the Year Ended June 30, 2017

	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Vocational Rehabilitation Administration	Total Enterprise Funds
CASH FLOWS FROM OPERATING ACTIVITIES					
Receipts from insurance taxes	$ 221,611,376	$ 12,546,807	$ 4,454,236	$ -	$ 238,612,419
Payments from customers	-	-	-	363,578	363,578
Payments to suppliers	-	(1,148,828)	(712,770)	(461,740)	(2,323,338)
Payments to employees	-	(5,971,168)	(2,759,891)	(272,895)	(9,003,954)
Payments for insurance benefits	(126,498,840)	(1,589,032)	(803,454)	-	(128,891,326)
Net cash provided by (used in) by operating activities	95,112,536	3,837,779	178,121	(371,057)	98,757,379
CASH FLOWS FROM CAPITAL AND RELATED FINANCINGS ACTIVITIES:					
Payments for capital assets	-	-	-	(5,897)	(5,897)
Net cash used by capital financing activities	-	-	-	(5,897)	(5,897)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:					
Contributions from Federal government	1,394,674	-	-	467,000	1,861,674
Loan to Commonwealth government	-	(15,000,000)	-	-	(15,000,000)
Transfers to other funds	(46,796,843)	(1,400,000)	(1,378,380)	(592,818)	(50,168,041)
Net cash used in financing activities	(45,402,169)	(16,400,000)	(1,378,380)	(125,818)	(63,306,367)
CASH FLOWS FROM INVESTING ACTIVITIES:					
Insurance received on deposits, investments and loans	11,558,646	2,163,540	3,637,277	-	17,359,463
Reserve for loss on deposits on the Government Development Bank	(47,016)	-	(13,000)	-	(60,016)
Proceeds from sales and maturities of investments	-	4,963,716	-	-	4,963,716
Purchase of investments	-	(6,000,060)	-	-	(6,000,060)
Net cash provided by investing activities	11,511,630	1,127,196	3,624,277	-	16,263,103
NET CHANGE IN CASH AND CASH EQUIVALENTS	61,221,997	(11,435,025)	2,424,018	(502,772)	51,708,218
CASH AND CASH EQUIVALENTS - Beginning of year	497,996,012	64,655,262	7,427,321	790,773	570,869,368
CASH AND CASH EQUIVALENTS - End of year	$559,218,009	$53,220,237	$9,851,339	$288,001	$622,577,586
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:					
Operating income (loss)	$86,859,690	$5,878,759	$249,551	$(504,760)	$92,483,240
Adjustments to reconcile income (loss) to net cash provided by (used in) operating activities:					
Depreciation expense	-	34,207	-	49,655	83,862
Bad debt expense	-	-	-	56,512	56,512
Changes in operating assets and liabilities:					
(Increase) decrease in accounts receivable	9,147,726	(621,156)	50,897	50,048	8,627,515
(Increase) decrease in inventories	-	-	-	130,602	130,602
(Increase) decrease in other assets	-	-	-	(69,397)	(69,397)
Increase in accounts payable and accrued liabilities	-	(191,693)	96,533	(86,719)	(181,879)
Increase (decrease) in unearned revenues	2,962,115	(1,093,046)	1,764	-	1,870,833
Decrease due to other governmental entities	-	-	(57)	-	(57)
Increase (decrease) in compensated absences	-	(160,043)	(72,749)	78,254	(154,538)
Increase (decrease) in insurance benefits payable	(3,856,995)	(9,249)	(147,818)	(75,252)	(4,089,314)
Total adjustments	8,252,846	(2,040,980)	(71,430)	133,703	6,274,139
Net cash provided by (used in) financing Activities	$ 95,112,536	$ 3,837,779	$ 178,121	$ (371,057)	$ 98,757,379

See accompanying notes to the basic financial statements.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
STATEMENT OF NET POSITION - AGENCY FUNDS
June 30, 2017

ASSETS	
Cash and cash equivalent in commercial banks	$ 13,182,288
TOTAL ASSETS	$ 13,182,288
LIABILITIES AND FUND BALANCES	
LIABILITIES:	
Account payable	$ 13,182,288
TOTAL LIABILITIES	$ 13,182,288

See accompanying notes to the basic financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation and Reporting Entity

The **Department of Labor and Human Resources of the Commonwealth of Puerto Rico** (the **Department**) is an Executive Department of the Commonwealth of Puerto Rico (the Commonwealth) created by Act 15 of April 14, 1931, as amended, to promote the working-class welfare, improve job conditions, and help reduce unemployment in Puerto Rico. The Governor of the Commonwealth appoints the Secretary of the **Department**.

The **Department** is included for financial reporting purposes as an instrumentality of the Commonwealth's financial statements. Its governmental funds' financial data is included as part of the general government section in the general fund, while its enterprise funds' financial data is included as part of the business-type activities for proprietary funds of the Commonwealth's basic financial statements.

On November 14, 2011, the Reorganization Plan Number 9 was created to amend Act No. 15 of April 14, 1931, which created originally the **Department**. Effective January 8, 2012, the Department was reorganized to merge and transfer all the operations, personnel, assets, functions and powers of the Future Entrepreneurs and Worker's Training Administration (FEWTA) and Right to Employment Administration (REA) to the **Department**.

The FEWTA was created to provide educational improvement services, vocational training, work experience, supportive service, and community action improvement to young people in Puerto Rico. Its operations are funded through an annual budget appropriation approved by the legislative bodies of the Commonwealth, and through financial assistance received from federal agencies. FEWTA operates through several resident centers, workshops, and various other training programs.

The REA was responsible for the implementation of policies and the administration of federal programs aimed at providing work opportunities incentives through the Island.

The accompanying basic financial statements of the **Department** have been prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). These basic financial statements present the financial position, the results of operations of the **Department** and its various funds and fund types, and the cash flows of the enterprise funds. The basic financial statements are presented as of June 30, 2017, and for the fiscal year then ended. These statements also include the Vocational Rehabilitation Administration (the Administration), which is an organizational component of the **Department**.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Basis of Presentation and Reporting Entity (Continued)

Vocational Rehabilitation Administration

The Administration was created by Act No. 414 of May 13, 1947. The Administration is ascribed to the Puerto Rico Department of Labor and Human Resources pursuant to the provisions of Act 97 of June 10, 2000. The Administration provides rehabilitation services to individuals with physical and/or mental disabilities and assists those individuals in obtaining an employment and improving their quality of life and self-esteem.

Complete financial statements of the Administration can be directly obtained by contacting its administrative offices at:

Vocational Rehabilitation Administration
PO Box 191118, San Juan, PR 00919-1118

Component Unit

A component unit is a legally separate entity, for which the **Department** is financially accountable, or the nature or significance of their relationship with the **Department** is such, that their exclusion would cause the **Department's** basic financial statements to be misleading or incomplete. Financial accountability exists if the primary government appoints a voting majority of the entity's governing body, and if either one of the following conditions exist: the primary government can impose its will on the other entity or the potential exists for the other entity to (1) provide specific financial benefits to or (2) impose specific financial burdens on the primary government. A second criterion used in evaluating potential component units is if the nature and significance of the relationship between the entity and a primary government are such that to exclude the entity from the financial reporting entity would render the financial statements misleading or incomplete. US GAAP details two methods of presentation: blending the financial data of the component unit's balances and transactions in a manner similar to the presentation of the **Department's** balances and transactions or discrete presentation of the component unit's financial data in columns separate from the **Department's** balances and transactions. Based on the above criteria there are no potential component units that should be included as part of the financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Basis of Presentation and Reporting Entity (Continued)

The accompanying basic financial statements present the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the **Department**, as of June 30, 2017, the respective changes in financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information for the fiscal year ended June 30, 2017, and the cash flows of the proprietary funds for the fiscal year ended June 30, 2017 in conformity with accounting principles generally accepted in the United States of America (GAAP), as prescribed by the Governmental Accounting Standards Board (GASB).

As further explained in **Note 10**, the Employees Retirement System of the Commonwealth of Puerto Rico did not provide the **Department** the information needed to adopt GASB Statement No. 68, *"Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27"* ("GASB 68"). Accordingly, these financial statements do not contain any adjustments, disclosures or required supplementary information required by GASB 68.

B. Government-Wide and Fund Financial Statements

Government-wide Financial Statements - The Statement of Net Position and the Statement of Activities report information on all of the non-fiduciary activities of the **Department**. The effect of inter-fund balances has been removed from the government-wide Statement of Net Position, except for the residual amounts due between governmental and business-type activities. Inter-fund charges for services among functions of the government-wide Statement of Activities have not been eliminated. The **Department's** activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through intergovernmental revenues and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for services and interest earned on investment securities.

The Statement of Net Position presents the **Department's** assets and liabilities, with the difference reported as net position. The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include: (1) fees and charges to customers for services rendered or for privileges provided by a given function, and (2) grants and contributions that are restricted to meet the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues are reported as general revenues.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Government-Wide and Fund Financial Statements (Continued)

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 financial activities of the **Department** that are reported in the accompanying basic financial statements have been classified into governmental, enterprise and agency funds.

Separate financial statements are provided for governmental funds, enterprise funds and agency funds, even though the latter is excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column, except for those governmental non-major funds, which management has elected to present separately in the financial statements. In the case of governmental funds, each individual agency of the **Department** has been reported as a separate major fund in the fund financial statements.

C. 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 recognized when earned and expenses are recognized when incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met.

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 **Department** considers revenues to be available if they are collected within sixty (60) days, after year end. In applying the susceptible to accrual concept to the intergovernmental revenues related to federal grants, there are essentially two types of revenue. For the majority of grants, monies must be expended by the **Department** on the specific purpose or project before any amounts will be reimbursed. Revenue is, therefore, recognized as expenditures are incurred to the extent available. For other revenues, moneys are virtually unrestricted and are generally revocable only for failure to comply with prescribed compliance requirements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

These resources are reflected as revenue at the time of receipt or earlier if the susceptible to accrual criteria is met. Expenditures are generally recognized when the related liability is incurred, as under accrual accounting. Modifications to the accrual basis of accounting include the following:

1. Employee's vested annual vacation and sick leave is recorded as expenditure when utilized. The amount of accumulated annual vacation and sick leave unpaid at June 30, 2017 has been reported only in the government-wide financial statements.

2. Executory purchase orders and contracts are recorded as an assignment of fund balance.

Enterprise and Agency Funds

The financial statements of the enterprise and agency funds are reported using the economic resources measurement focus and the accrual basis of accounting, similar to the government-wide statements described above.

The accounting and reporting policies of the **Department** conform to US GAAP, as applicable to governmental entities. The **Department** follows GASB Statements under the hierarchy established by GASB Statement No. 76, *"The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments"*, in the preparation of its basic financial statements.

Enterprise funds distinguish between operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services in connection with an enterprise fund's principal ongoing operations. The major operating revenues of the **Department** are as follows:

- **Unemployment Insurance Fund -** Amounts for charges made to individual employers for payment of unemployment benefits.
- **Disability Insurance Fund -** Amounts for charges made to individual employers for payment of temporary non-occupational disability benefits.
- **Drivers' Insurance Fund -** Amounts for charges made to individual employers for payment of benefits for drivers in Puerto Rico. Also, provides benefits for health and life insurance.
- **Vocational Rehabilitation Administration –** Accounts for operating revenues of the program for the Industry of Blind and Physical, Mental, and Development Disabilities Persons.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. The major non-operating revenues of the **Department's** enterprise funds are mainly contributions from the federal government under various extended unemployment benefits programs.

Governmental Funds - The **Department** reports its financial position and results of operations in funds, which are considered separate accounting entities. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of assets, liabilities, revenue, or expenditures/expenses of either the fund category or the governmental and enterprise funds combined.

The non-major funds are combined in a single column in the fund financial statements column, except for those governmental non-major funds for which management has elected to present separately in the financial statements.

The **Department** reports the following major governmental funds:

General Fund - is the fund in which all governmental activities, except those which are required to be recorded for in another fund, are accounted for. Its revenues consist mainly of intergovernmental revenues.

Work Opportunity Incentive Fund - is the fund that accounts for revenues derived from state or other restricted revenue sources, for the uses and limitations specified by state statutes to promote job opportunities and the creation of high demand employments in current markets.

Vocational Rehabilitation Administration - is the fund that accounts for revenues derived from state and federal grants for rehabilitation services, improvements and maintenance to facilities and other funds.

Other Governmental Funds – are the funds that account for revenues derived from federal grants sources, for the uses and limitations specified by federal statutes.

Enterprise Funds - These are the funds that account for the operations of the **Department** that are financed and operated in a manner similar to those often found in the private sector. The **Department** reports the following major enterprise funds:

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

Unemployment Insurance Fund - It is used to account for contributions made by employers to provide unemployment benefits under the State Unemployment Insurance Program created by Act 74 on June 21, 1956.

Disability Insurance Fund - It is used to account for disability benefits to temporarily remedy the loss of income as a result of disability caused by sickness or accident unrelated to the employment under the Temporary Non-occupational Disability Insurance Program created by Act 139 on June 26, 1968.

Drivers' Insurance Fund - It is used to account for contributions made by the drivers and their employers to provide an insurance plan for the benefit of the drivers in Puerto Rico under the Drivers' Insurance Program created by Act 428 on June 15, 1950. The plan also includes benefits for health and life insurance.

The **Department's** enterprise funds provide unemployment compensation, non-occupational disability, and drivers' insurance coverage to public and private employees through various insurance programs administered by the **Department**. These insurance programs cover workers against unemployment, temporary disability, or death because of work or employment related accidents or because of illness suffered as a consequence of their employment.

State Unemployment Insurance Program - The structure of the Federal-State UI Program partnership is based upon federal law; however, it is implemented primarily through state law. Unless otherwise noted, responsibilities of the US Department of Labor (US DOL) include: (1) allocating available administrative funds among states; (2) administering the Unemployment Trust Fund (UTF) through the US Treasury and monitoring activities of the UTF; (3) establishing program performance measures; (4) monitoring state performance; (5) ensuring conformity and substantial compliance of state law and operations with federal law; and (6) setting broad overall policy for program administration. State UI program operations are accounted for in the **Department's** Unemployment Insurance Fund.

State responsibilities include: (1) establishing specific, detailed policies and operating procedures that comply with the requirements of federal laws and regulations; (2) determining the State UI tax structure; (3) collecting State UI contributions from employers (commonly called "unemployment taxes"); (4) determining claimant eligibility and disqualification provisions; (5) making payment of Regular Unemployment (UC) benefits to claimants; (6) managing the program's revenues and benefit administrative functions; (7) administering the programs in accordance with established policies and procedures; and (8) enacting State UC law that conforms with Federal UC law.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

The Federal Unemployment Tax Act (FUTA) imposes a federal tax on covered employers. Currently, the FUTA tax on covered employment (generally Employment subject to a State UI tax) is 6% of the first $7,000 of covered employee wages. Employers, however, receive two credits against the FUTA tax. One credit is equal to the amount of State UI tax paid by the employer. The employer receives this credit when the State UI law, and its application, conforms and substantially complies with FUTA requirements.

A second credit is awarded only to employers in states which have a federally approved experience-rate State UI tax system. All states currently meet the federal criteria for both credits to be applicable to the states' employers. The two credits combined cannot exceed 5.4% of taxable employee wages.

FUTA revenues from the remaining 0.6% are collected by the IRS and deposited into the general fund of the US Treasury, which by statute are appropriated to the UTF. FUTA revenues are used primarily to finance federal and state administrative expenses, the federal share of Extended Benefits (EB) and advances to states whose UTF account balances are low or exhausted. US DOL allocates available administrative grant funds (as appropriated by Congress) to states based on forecasted workload and costs and adjusted for increases or decreases in workload during the current year.

The quarterly tax rate imposed for the State UI Program is computed based on experience rates determined for each employer individually. In addition, a special tax of 1% of taxable compensation will be collected from all nongovernmental employers to promote activities related to the creation of jobs and other related working initiatives. However, the total tax imposed will never be more than 5.4% of the taxable salaries as established by federal regulations.

Unemployment benefits are provided under UC and the EB programs as follows:

UC provides benefits to workers generally after a waiting period of one week of unemployment, provided that each claimant has worked during a base period generally established as the first four (4) of the last five (5) completed calendar quarters prior to filing the claim. A waiting period is defined as a non-compensable period of unemployment for such acts as leaving voluntarily without good cause, discharge for misconduct connected with work, and refusal of suitable work.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

The normal benefit will depend on the worker's age and weeks of work-covered employment in the base period.

EB provides benefits for claimants that have exhausted the UC. To be eligible for a work of EB, a claimant must apply for and be able to and available to accept suitable work, if offered. What constitutes suitable work is dependent on a required evaluation of the claimant's employment prospects and as part of this process the claimant must make a "systematic and sustained effort" to seek work and must provide "tangible evidence" that he or she has done so.

Temporary Non-occupational Disability Insurance Program - This program consists of a benefit plan for workers. A tax of .6% is levied by the program of which the employer and employee pays .3% each. Taxable amount is limited to the first $9,000 of the employee's yearly salary. Contributions received under the program are accounted for in the **Department's** Disability Insurance Fund and are deposited in an interest-bearing account to provide for future claims, as established by law.

Disability benefits are provided for a maximum of 26 weeks to workers that have suffered accidents or illness not related to the work place. Disbursements per week will range from $12 to $113 and are dependent on the claimant's salary. In order to qualify for benefits, claimants must also comply with certain working time as established in the regulations.

Drivers' Insurance Program - This program provides benefits to workers that use motor vehicles as part of their job duties. The program's benefits include payments to claimants due to death, disability and other benefits to dependents. Funding for the program is provided by a quarterly contribution of eighty cents per employee of which the employer pays thirty cents and fifty cents are paid by the employee. The program's operations are accounted for in the **Department's** Drivers' Insurance Fund.

Workers claiming benefits under this program must have worked at least 25 weeks prior to any claim related to disability benefits, and at least 10 weeks for death benefits. Benefits payable are calculated in a similar fashion as benefits paid in the disability program, but claimants under the Drivers' Insurance program must be workers that use a motor vehicle as part of their primary job duties.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation (Continued)

Taxes and contributions of all programs are due the next day following the levy date, although a 30-day grace period is provided. All of the above taxes and contributions are recognized as operating revenues in the corresponding enterprise fund.

Agency Funds - These are the funds that account for the assets held by the **Department** as a trustee or agent for individuals, private organizations and/or governmental units and, therefore, are not available to support the **Department's** own programs. These funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations.

D. Budgetary Accounting

The **Department's** budget is adopted in accordance with a statutory basis of accounting, which is not in accordance with US GAAP. Revenues are generally recognized when cash is received, and expenditures are generally recorded when the related expenditure is incurred or encumbered. Available appropriations and encumbrances will lapse the year following the end of the fiscal year when the encumbrances were established, as prescribed by Act No. 123 of August 17, 2001. Unencumbered appropriations lapse at year-end. Amounts required for the settlement of claims and judgments against the **Department**, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment.

Under the statutory basis of accounting, the **Department** 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 governmental funds, encumbrance accounting is a significant aspect of budgetary control.

The Budgetary Comparison Schedule – The General Fund presents only the information for which there is a legally adopted budget, as required by US GAAP. See notes to Budgetary Comparison Schedule - General Fund for a reconciliation of such statement with the Statement of Revenues, Expenditures, and Changes in Fund Balance for the general fund. The other governmental funds do not have a legally mandated budget.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Cash and Cash Equivalents

Cash accounts of the **Department** as presented in the Balance Sheet - Governmental Funds are mainly held by the Department of Treasury of the Commonwealth of Puerto Rico (PR Treasury). All disbursements of the **Department** were made through the Government Development Bank for Puerto Rico (GDB), an internal service unit of the Commonwealth up until April 2016. GDB maintains separate codes at the general government account to identify each governmental unit. No collateral was maintained for cash accounts in GDB as of June 30, 2017. From May 2016, all the disbursements are made through a local commercial bank. The **Department** considers currency on hand, demand deposits and highly liquid investments (including restricted cash purchased with a maturity of three (3) months or less) to be cash equivalents.

The **Department** has a certificate of deposit (CD) held by the Economic Development Bank (EDB), with a three-month maturity and, therefore, is considered a cash equivalent. The purpose of this CD is to serve as collateral to the loans made to young entrepreneurs, alumni of the Entrepreneurship Program. The deposit bears interest at the rate resulting from the difference between the LIBOR rate of three (3) months less point three seventy-five (.375) of one percent (1%). As of June 30, 2017, the interest rate was point two seventy-five percent (.275). Cash balances not held at GDB are controlled by various special collector officials and deposited in qualified depositories. Under the Commonwealth's statutes, public funds deposited in commercial banks must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the PR Treasury. The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit with the US Treasury. Interest earned over such deposit is maintained in the fund.

F. Restricted Investments

Investments include US Government and agencies' obligations, mortgage-backed securities, and corporate debt and equities. Investment securities are presented at fair value. Changes in the fair value of investments are presented as investment earnings (losses) in the Statement of Activities and the Statement of Revenues, Expenditures, and Changes in Net Position - Enterprise Funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Receivables

Unemployment, disability and drivers' insurance receivables in the enterprise funds are stated net of estimated allowance for uncollected accounts, which are determined based upon past collection experience. Intergovernmental receivables primarily represent amounts owed to the **Department** for reimbursement of expenditures incurred pursuant to the federally-funded programs.

H. Inventories

Inventories are stated at the lower of cost or market and predominantly on a first-in, first-out basis. Inventories are recorded as expenditures/expenses when purchased, rather than capitalized as an asset. Only significant amounts of inventories at the end of the year are capitalized in the governmental funds. A fund balance restriction equal to the value of the inventories is established in the general fund and in other governmental funds to indicate that the inventories do not constitute expendable financial resources available for appropriation. However, inventories are capitalized in the Statement of Net Position of the business-type activities and in the enterprise funds' Statement of Net Position.

I. Restricted Assets

Funds set aside for specified purposes are classified as restricted assets, since their use is limited for a specific purpose by applicable agreements or required by law. Restricted assets in the enterprise funds mainly include amounts set aside for the payment of unemployment and disability insurance benefits.

J. Capital Assets

Capital assets, which include buildings, furniture, equipment, and vehicles, are stated at cost less accumulated depreciation, and are reported in the governmental activities column in the government-wide financial statements. The **Department** defines capital assets as assets that have an initial individual cost of $25,000 or more at the date of acquisition and have a useful life of five (5) or more years, while the Vocational Rehabilitation Administration uses an initial individual cost of $500. Such assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at acquisition value at the time of donation. Costs of maintenance and repairs that do not improve or extend the lives of the respective assets are charged to expense as incurred.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

J. Capital Assets (Continued)

Several buildings, including related improvements, owned or under capital lease by the **Department** are recorded as capital assets of the Department of Transportation and Public Works of the Commonwealth. Accordingly, all major improvements and betterments done by the **Department** are charged to expenditures in the governmental funds financial statements and reported as an expense in the government-wide financial statements.

Capital assets utilized in governmental funds are recorded as expenditures in the governmental funds financial statements. Depreciation expense is recorded in the government-wide financial statements, as well as the enterprise funds financial statements.

Capital assets of the **Department** are depreciated using the straight-line basis over the estimated useful lives of the depreciable assets. Estimated useful lives are as follows:

	Years
Buildings	30
Furniture and equipment	5 - 10
Computer equipment and software	5
Vehicles	5 - 10

The **Department** follows the provisions of GASB Statement No. 42, *"Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries - an amendment of GASB Statement No. 34"*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

K. Unearned Revenue

Unearned revenue arises when resources are received before the **Department** has a legal claim to them, as well as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the **Department** has a legal claim to the resources, the liability for unearned revenue is removed from the balance sheet and revenue is recognized. Unearned revenue at the government-wide and enterprise funds level arises only when the **Department** receives resources before it has a legal claim to them.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

L. Deferred outflows/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 (expense/expenditure) 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.

The government has three (3) items that qualify for reporting in this category:

1. **Government-mandated or voluntary non-exchange transactions received before the time requirements have been met -** Federal and state grants received before the beginning of the fiscal year to which they pertain are recognized as deferred inflows of resources on both the balance sheet of the governmental funds and in the government-wide statement of net position. The amounts deferred would be recognized as an inflow of resources (revenue) in the period in which the time requirements are fulfilled.

2. **Unavailable revenue reported under the modified-basis of accounting -** Amounts collected or to be collected after the availability period are recognized as unavailable revenue in the governmental funds balance sheet. The amounts are deferred and recognized as an inflow of resources (revenue) in the period that the amounts become available. Since this deferred inflow of resources is the result of the modified-accrual basis of accounting, it is only reported in the governmental fund financial statements.

3. **Deferred outflows/inflows of resources related to pensions -** Amounts reported for changes in calculation of the net pension liability that result from: a) differences between expected and actual experience; b) changes of assumptions; c) net difference between projected and actual earnings on pension plan investments; d) changes in proportion and difference between the **Department's** contributions and proportionate share contributions; and e) **Department's** contributions subsequent to the measurement date.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

M. Benefits Payable

Benefits payable arise from participants' insurance benefit claims of the unemployment, disability and drivers' insurance programs in the enterprise funds. Liabilities for incurred but unpaid benefits and for benefit adjustment expenses are based on the ultimate cost of settling the benefits. Insurance benefits claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The insurance benefits liability is reported as a current liability in the accompanying Statement of Net Position for Business-type Activities and the Statement of Net Position - Enterprise Funds.

N. Long-term obligations

The liabilities reported in the government-wide financial statements include the **Department's** compensated absences obligations (vacation and sick leave), accrued pension plan obligation (early retirement program), and the employees' Christmas bonus. Long-term obligations financed by the enterprise funds are recorded as liabilities in those funds.

O. Compensated Absences

The **Department's** employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. The **Department's** employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated benefits are accrued when incurred in the government-wide financial statements, and in the enterprise funds financial statements, when the employee meets such criteria. Such compensated benefits accrual also includes related estimated payroll taxes.

The "Public Service Personnel Law" required the **Department** unit to pay annually the accumulated vacation and sick leave earned in excess of the limits mentioned above. As a result of Act No. 66 of June 17, 2014 (also known as the Fiscal Operation and Sustainability Act), some of these excess accumulations are no longer going to be payable to employees.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

O. Compensated Absences (Continued)

On April 29, 2017, Act No. 26, the "Fiscal Plan Compliance Act," was created in order to take measures as necessary to adjust the existing legal and juridical framework so as to allow the fullest compliance with the Fiscal Plan approved by the Financial Oversight Board, created by virtue of the Federal Law PROMESA. It establishes a uniform fringe benefit system, which includes the Christmas bonus and the healthcare plan contribution, for all the government employees and officials of the agencies, instrumentalities, and public corporations of the Government of Puerto Rico, except for the University of Puerto Rico. Among other measures, the Act reduces accumulation of vacation leave to a new rate of 1.25 days per month up to a maximum of 60 days and 8 hours of sick leave (12 days per year).

P. Accounting for Pension Costs

The **Department** shall adopt the provisions of GASBS No. 68, *"Accounting and Reporting for Pensions - an amendment of GASBS No. 27"*, and GASBS No. 71, *"Pension Transition for Contributions Made Subsequent to the Measurement Date"*, which amended GASBS No.68.

The **Department** accounts for pension costs from the standpoint of a participant in a multi-employer cost-sharing plan. Accordingly, the net pension liability, pension expense and deferred outflows/inflows of resources recognized in the accompanying basic financial statements shall be equal to the **Department's** proportionate shares of the collective net pension liability, pension expense and collective deferred outflows/inflows of resources reported for the pension plans' trust by the plan's administrator as of the measurement date.

In addition, if the **Department's** annual contributions are less than the statutorily required amounts, a liability is recorded for any unpaid balances.

For the purpose of applying the requirements of GASBS Nos. 68 and 71, the Commonwealth of Puerto Rico is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS), a multi-employer hybrid defined contribution plan in which the employees of the **Department** participate. The **Department** is considered a participant, and not a sponsor, of this retirement system since the majority of the participants in the aforementioned pension trust fund are employees of the Commonwealth of Puerto Rico and the basic financial statements of such retirement system are part of the Commonwealth's financial reporting entity.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

P. Accounting for Pension Costs (Continued)

For purposes of measuring the net pension liability, deferred outflows/inflows of resources related to pensions and pension expense, information about the fiduciary net position of the ESR plan and additions to/reductions from the ESR plan's fiduciary net position have been determined on the same basis as they are reported by the ESR. 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. The basic financial statements of such retirement system are part of the Commonwealth's financial reporting entity.

The **Department's** pension plan administrator has not provided the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability as of June 30, 2017. As a result, the management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68.

Q. Fund Balances and Net Position

The fund balance classifications are as follows:

Non-expendable: Amounts that cannot be spent because they are either (a) not in expendable form or (b) legally or contractually required to be maintained intact.

Restricted: Amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

Committed: Amounts that can be used only for the specific purposes determined by a formal action of the **Department's** highest level of decision-making authority. Those committed amounts cannot be used for any other purposes unless the highest level of decision-making authority for the **Department** removes or changes the specified use by taking the same type of action it employed to commit those amounts.

Assigned: Amounts that are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Q. Fund Balances and Net Position (Continued)

Unassigned: Is the residual classification for the **Department's** general fund and includes all expendable amounts not contained in other classifications. For all other governmental funds, the unassigned classification is used only to report a deficit balance resulting from the overspending for specific purposes for which amounts had been restricted, committed or assigned.

In the government -wide statements the net position is segregated in three (3) categories:

- **Net investment in capital assets:** It consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances for debt that are attributed to the acquisition, construction, or improvement of those assets.

- **Restricted net position:** It 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:** It consists of net position that does not meet the definition of the two (2) preceding categories. Unrestricted net position often is designated, in order to indicate that management does not consider them to be available for general operations. Unrestricted net position often has constraints on use that are imposed by management, but such constraints may be removed or modified.

In the government-wide financial statements, when both restricted and unrestricted resources are available for use, it is the **Department's** policy to use restricted resources first and then the unrestricted resources, as they are needed. Similarly in the fund financial statements, within unrestricted fund balance, committed amounts are reduced first, followed by assigned, and then, unassigned amounts when expenditures are incurred for purposes for which amounts in any of the unrestricted fund balance classifications could be used.

Part of the deficit shown in the unrestricted fund balance within the governmental activities column in the Statement of Net Position is comprised of the deficit from the Work Opportunity Incentive Fund. Deficit arises mainly from the excess of the administrative costs related to the various job opportunity programs created by this fund over the restricted revenue sources it receives which are established by law.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

R. Encumbrances

Encumbrances accounting, under which purchase orders, contracts and other commitments for expenditures are recorded to reflect the use of the applicable spending appropriations, is used by governmental funds during the fiscal year to control expenditures. The cost of those goods received and services rendered on or before June 30 are recognized as expenditures. For GAAP reporting purposes, encumbrances outstanding at year-end are reported within the restricted, committed, and assigned GAAP fund balance classifications and do not constitute expenditures or liabilities on GAAP basis because the commitments will be honored during the subsequent year.

S. Inter-fund and Intra-entity Transactions

The **Department** has the following types of transactions among funds:

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

Intra-entity Transactions **-** Intra-entity transactions are resource flows among the **Department** and component units of the Commonwealth. These resource flows and related outstanding balances are reported as if they were external transactions. However, resource flows among the **Department** and its agencies are classified as inter-fund transactions, as described above.

T. Risk Management

The **Department** carries commercial insurance to cover property and casualty, theft, tort claims and other losses of the **Department**. Insurance policies are negotiated by the PR Treasury and costs are allocated among all the governmental units of the Commonwealth. Cost of insurance allocated to the **Department** and reimbursed to the PR Treasury amounted to $198.6 thousand for the fiscal year ended June 30, 2017. The current insurance policies have not been cancelled or terminated.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

T. Risk Management (Continued)

The State Insurance Fund Corporation, a component unit of the Commonwealth, provides workmen compensation insurance to cover the employees of the **Department**. The **Department's** workmen compensation insurance expenditures amounted to $2.7 million for the fiscal year ended June 30, 2017. In the past three years, the **Department** has not settled claims that exceed insurance coverage.

U. Reclassifications

Certain reclassifications have been made to the information presented in the separately issued financial statements of the **Department's** organizational component agencies to conform to the accounting classifications used by the **Department** in the basic financial statements.

V. Use of Estimates

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

W. Adoption of new accounting pronouncements – GASB Statements No. 74, 77, 78, 80 and 82

Effective July 1, 2016, the Department adopted the provisions of the following GASB Statements:

- **GASB Statement No. 74 "Financial Reporting for Postemployment Benefit Plans Other Than Pensions."** The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. This Statement replaces Statements No. 43, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans", as amended, and No. 57, "OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans". It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans", as amended, Statement 43, and Statement No. 50, "Pension Disclosures".

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

W. Adoption of new accounting pronouncements – GASB Statements No. 74, 77, 78, 80 and 82 (Continued)

- **GASB Statement No. 77 "*Tax Abatement Disclosures.*"** Financial statement users need information about certain limitations on a government's ability to raise resources. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development.

  For financial reporting purposes, this Statement defines tax abatement as resulting from an agreement between a government and an individual or entity in which the government promises to forgo tax revenues and the individual or entity promises to subsequently take a specific action that contributes to economic development or otherwise benefits the government or its citizens. Although many governments offer tax abatements and provide information to the public about them, they do not always provide the information necessary to assess how tax abatements affect their financial position and results of operations, including their ability to raise resources in the future. This Statement requires disclosure of tax abatement information about (1) a reporting government's own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government's tax revenues.

- **GASB Statement No. 78 "*Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans.*"** The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, "*Accounting and Financial Reporting for Pensions*". This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

W. Adoption of new accounting pronouncements – GASB Statements No. 74, 77, 78, 80 and 82 (Continued)

- **GASB Statement No. 80 *"Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14".*** The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *"The Financial Reporting Entity"*, as amended. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, "*Determining Whether Certain Organizations Are Component Units*".

- **GASB Statement No. 82 *"Pension Issues-an amendment of GASB Statements No. 67, No. 68 and No. 73".*** The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, "*Financial Reporting for Pension Plans*", No. 68, "*Accounting and Financial Reporting for Pensions*", and No. 73*, "Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*". Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

The implementation of these Statements has no significant impact on the **Department's** financial statements for the fiscal year ended June 30, 2017.

X. Future Adoption of Accounting Pronouncements

- **GASB Statement No. 75, "*Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*"**, was issued in June 2015. The provisions in this Statement are effective for fiscal years beginning after June 15, 2017. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (other postemployment benefits or OPEB).

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

X. Future Adoption of Accounting Pronouncements (Continued)

- **GASB Statement No. 81, "*Irrevocable Split-Interest Agreements*"**, was issued in March 2016. The requirements of this Statement are effective for periods beginning after December 15, 2016. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement.

- **GASB Statement No. 83, "*Certain Asset Retirement Obligation*"**, was issued in November 2016. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. 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.

- **GASB No. 84, "*Fiduciary Activities*"**, was issued in January 2017. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. This Statement establishes criteria for identifying fiduciary activities of all state and local governments.

- **GASB No. 85, "*Omnibus 2017*"**, was issued in March 2017. The provisions of this Statement are effective for periods beginning after June 15, 2017. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements.

- **GASB No. 86, "*Certain Debt Extinguishments Issues*"**, was issued in May 2017. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources other than the proceeds of refunding debt are placed in an irrevocable trust for the sole purpose of extinguishing debt.

- **GASB No. 87, "*Leases*"**, was issued in June 2017. The provisions of this Statement are effective for reporting periods beginning after December 15, 2019. The objective of this Statement is to better meet the information needs of financial statements users by improving accounting and financial reporting for leases by governments.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

X. Future Adoption of Accounting Pronouncements (Continued)

- **GASB Statement No. 88 "Certain Disclosures related to debt, including direct borrowings and direct placements"**. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified 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 debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018 (December 31, 2019). Earlier application is encouraged.

The impact of most of these statements on the **Department's** basic financial statements has not yet been determined.

Y. Date of Management's Review

The **Department** has evaluated events and transactions for potential recognition or disclosures through June 28, 2018, the date the financial statements were available to be issued.

NOTE 2 - CASH AND CASH EQUIVALENTS

Cash and cash equivalents in the governmental and enterprise funds consist of demand deposits, interest bearing accounts, and bank investment contracts. The carrying amount of deposits of the **Department** at June 30, 2017 consists of the following:

	Carrying Amount			Depository Bank	Amount Uninsured and
	Unrestricted	**Restricted**	**Total**	**Balance**	**Uncollateralized**
Commercial bank	$ 41,226,883	$ 1,898,708	$ 43,125,591	$ 53,583,938	$ -
Governmental bank	95,582,755	1,523,480	97,106,235	96,426,174	96,426,174
US Treasury	-	557,540,006	557,540,006	557,653,896	-
Total	$ 136,809,638	$ 560,962,194	$ 697,771,832	$ 707,664,008	$ 96,426,174
Less: Reserve for impairment loss on deposits – Governmental Bank	(94,338,361)	(1,126,359)	(95,464,720)		
Total after reserve for loss on deposits	$ 42,471,277	$ 559,835,835	$ 602,307,112		

Custodial credit risk is the risk that in the event of bank failure, the **Department's** deposits might not be recovered. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance.

All securities pledged as collateral are held by banks in the Commonwealth's name. There is no formal policy for custodial credit risk for cash accounts with commercial banks outside Puerto Rico.

The **Department's** bank balance in commercial banks was covered by federal depository insurance or by collateral held by Secretary of the PR Treasury in the **Department's** name. The amounts deposited in the GDB are uninsured and uncollateralized. Such deposits are exempt from the collateral requirement established by the Commonwealth, and thus, represent a custodial credit risk, because in the event of GDB's failure, the **Department** may not be able to recover these deposits. The deposits with the US Treasury from unemployment insurance taxes are uninsured and uncollateralized. The deposits with the US Treasury from unemployment insurance taxes in the UFT can only be invested in obligations of the

NOTE 2 - CASH AND CASH EQUIVALENTS (CONTINUED)

US or obligations guaranteed by the US. In addition, the **Department** has deposits that are held by the PR Treasury (as fiscal agent of the **Department**). These amounts are uncollateralized.

Reserve for Impairment Loss on Deposits with Governmental Bank
The Commonwealth and the GDB face significant uncertainties, including liquidity risks, which is the risk of not having sufficient liquid financial resources to meet their obligations when they come due.

Pursuant to recently enacted legislation, the Governor of the Commonwealth has ordered the suspension of loan disbursements by GDB, imposed restrictions on the withdrawal and transfer of deposits from GDB, and imposed a moratorium on debt obligations of GDB, among other measures. As a result of the reductions in liquidity experienced subsequent to June 30, 2015, GDB took a number of liquidity enhancing and conservation measures and explored the sale of assets and other alternatives to address its liquidity needs. In light of GDB's significant debt service obligations during fiscal years 2015 and 2016, these measures, however, are not expected to be sufficient to maintain GDB's operations in the ordinary course absent the completion of a capital market transaction, a restructuring of GDB's debt, and the payment by the Commonwealth of debt service on GDB's public sector loans payable from annual appropriations. As a result of the non-payment by the Commonwealth of the appropriation to GDB and GDB's inability to restructure its debt in light of the broader fiscal crisis faced by the Commonwealth, GDB was not in a position to pay principal on its debt obligations due to May 1, 2016 and continue operations in the ordinary course. In April 2016, the Governor imposed on GDB emergency operational restrictions and debt moratorium described below. The GDB has continued to pay interest on its debt obligations.

Due to the conditions and events described above, GDB's management believes substantial doubt exists as the GDB's ability to continue as a going concern.

On October 18, 2016, the Secretary of the Treasury of the Commonwealth of Puerto Rico issued its Circular Letter 1300-08-17 confirming that there is substantial doubt that GDB may be able to continue operating as a going concern and that GDB is currently without financial liquidity. Based on this information, the Secretary recommended to all component units and other entities with deposits at GDB to evaluate and record a reserve for loss as of June 30, 2016, for amounts held at GDB.

The impairment loss on deposits for the fiscal year ended June 30, 2017 recorded in the Governmental and Enterprise Fund's basic financial statements was $67.3 and $60 thousand, respectively.

As a result, the reserve for impairment loss on deposits held with GDB was reported in the Governmental and Enterprise Fund's basic financial statements as of June 30, 2017 was approximately $82 and $13.4 million, respectively.

NOTE 3 - RESTRICTED INVESTMENTS

As required by law, the principal purpose of the Disability and Drivers' Insurance funds is to cover payments for benefits claimed. To comply with the obligations of such enterprise funds, aside from the insurance premiums collections, an adequate investment of the required reserves is necessary to ensure the solvency of these enterprise funds. Accordingly, the results from the investments are a critical element to achieve the objectives and obligations imposed by law.

The **Department's** investment policies for such enterprise funds establish limitations and other guidelines on amounts to be invested in the investment categories and by issuer/counterparty and on exposure by country. Such policies provide guidelines on the institutions with which investment transactions can be entered into. In addition, the investment committee and the Secretary of the **Department** will determine, from time to time, other transactions that such enterprise funds may enter into.

Inherent rate risk - In accordance with its investment policy, the Disability Insurance Fund manages its exposure to declines in fair values by establishing a long-term maturity of the investment portfolio of more than five years.

Credit risk - The **Department's** investment policy for the Disability Insurance Fund is to limit its investments pool rating of obligations and equities, not guaranteed by the US or its agencies, to not less than AAA by the Standard and Poor's (S&P) or AAA by the Moody's Investors Service (Moody's) and of corporate debt securities to the top three ratings by the S&P and Moody's.

Concentration of credit risk - The **Department's** investment policies for the Disability Insurance Fund does not allow for investment in debt securities in excess of 20% of the **Department's** enterprise funds fixed income investments and in small companies' equities in excess of 50% of the total equities investments.

Custodial credit risk - The risk that, in the event of the failure of the counterparty to the transaction, the **Department's** Disability Insurance Fund may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2017, securities investments were registered in the name of the Commonwealth and were held in the possession the Commonwealth's custodian bank.

Foreign currency risk - The **Department's** investment policy for the Disability Insurance Fund limits the investment in emerging countries to 50% of the total international equities.

All of the **Department's** investments of the Disability Insurance Fund in US Treasury securities and mortgage-backed securities guaranteed by Government National Mortgage Association (GNMA) carry the explicit guarantee of the US government and are presented as AAA to A- in the credit risk tables.

NOTE 3 - RESTRICTED INVESTMENTS (CONTINUED)

The fair value by investment type, credit quality ratings and maturity of the restricted investments reported by the business-type activities and the enterprise funds of the **Department** at June 30, 2017 consist of the following:

		Investment Rating				
	Fair Value	**AAA to A**	**BBB to B**	**CCC**	**Not Rated**	**No Risk**
Mortgage-backed securities	$ 4,391,929	$1,070,740	$ -	$ -	$ 426,341	$ 2,894,848
U.S. government and agency securities	4,852,044	521,910	-	-	-	4,330,134
U.S. equity securities	9,116,320	-	-	-	9,116,320	-
U.S. corporate debt securities	7,238,967	4,883,470	2,355,497	-	-	-
Other	653,294	595,998	57,296	-	-	-
Total	$ 26,252,554	$7,072,118	$2,412,793	$ -	$ 9,542,661	$ 7,224,982

		Maturity (in Years)			
	Fair Value	**No Stated Maturity**	**1 to 5 Years**	**6 to 10 Years**	**More Than 10 Years**
Mortgage-backed securities	$ 4,391,929	$ -	$ 842,239	$ 683,753	$ 2,865,937
U.S. government and agency securities	4,852,044	-	1,389,585	1,710,474	1,751,985
U.S. equity securities	9,116,320	9,116,320	-	-	-
U.S. corporate debt securities	7,238,967	-	3,686,667	2,619,203	933,097
Other	653,294	-	424,054	229,240	-
Total	$ 26,252,554	$ 9,116,320	$ 6,342,545	$ 5,242,670	$ 5,551,019

Fair Value of Investments - The Department measures and records its investments using fair value measurement guidelines established by generally accepted accounting principles. These guidelines recognize a three-tiered fair value hierarchy, as follows:

- Level 1: Quoted prices for identical investments in active markets;
- Level 2: Observable inputs other than quoted market prices; and,
- Level 3: Unobservable inputs.

NOTE 3 - RESTRICTED INVESTMENTS (CONTINUED)

		Fair Value Measurement Using		
	June 30, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment by fair value level				
Debts securities				
Asset backed securities	$ 4,391,929	$ -	$ 4,391,929	$ -
Corporate debt securities	7,892,261	-	7,892,261	-
Government debt securities	3,924,548	-	3,924,548	-
State and local government debt Securities	521,910	-	521,910	-
Structured debt	405,586	-	405,586	-
Total debt securities	17,136,234	-	17,136,234	-
Equity securities				
Others - equity funds	9,116,320	-	9,116,320	-
Total Equity Securities	9,116,320	-	9,116,320	-
Total investment by fair value level	$ 26,252,554	$ -	$ 26,252,554	$ -

The Department's carry all their investments at net fair value. The investment managers generally use the market approach to value its investment securities, which uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities or a group of assets and liabilities. As show in the table above, all the Department's debt and equity securities were classified in Level 2 of the fair value hierarchy. They are valued using either a bid evaluation or a matrix pricing technique. Bid evaluations may include market quotations, yields, maturities, call features and ratings. Matrix pricing is used to value securities' relationship to benchmark quoted prices.

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NOTE 4 - RECEIVABLES

Receivables in the Department's governmental funds include intergovernmental receivables from the federal government of $10 million. At June 30, 2017, amounts due from the US Department of Labor (USDOL) and US Department of Education (USDE) amounted $3.1 and $6.9 million, respectively.

Insurance tax premiums are levied each quarter to employers registered under the State Unemployment Insurance, the Temporary Non-occupational Disability Insurance and the Driver's Social Security Insurance Programs.

Federal contributions are received to reimburse the benefits paid mainly for extended unemployment benefits granted under the Emergency Unemployment Compensation and the Additional Unemployment Compensation programs and to unemployed ex-military and civilian ex-federal employees, whose unemployment is caused by a presidential declared disaster under the Disaster Relief Act, and adversely affected work under the Trade Act.

NOTE 5 - PAYABLES

Payables in the governmental funds include approximately $74 million (Including $3.1 million from the Vocational Rehabilitation Administration) of trade accounts due to suppliers for purchase of merchandise received and services rendered at June 30, 2017. Also, excess of checks drawn over the PR Treasury cash balance amounted to approximately $197.9 million, are reported within accounts payable and accrued liabilities of the governmental activities and the governmental funds.

Payables in the business-type activities include approximately $1.8 million of trade accounts due to suppliers for purchase of merchandise and services rendered and $103.7 thousands of accrued Christmas bonus at June 30, 2017.

Benefits payable in the enterprise fund include approximately $50.1 million of unemployment, disability and drivers' insurance benefits claims.

NOTE 6 - INTER-FUND AND INTRA-ENTITY TRANSACTIONS

Inter-fund receivables and payables at June 30, 2017 consist of:

Receivable Fund	Payable Fund	Amount
Drivers' Insurance	Work Opportunity Incentive	$ 2,060,249
Drivers' Insurance	General Fund	7,078,794
General Fund	Unemployment Insurance	439,536
Work Opportunity Incentive	Unemployment Insurance	6,602,311
Other Governmental Funds	Unemployment Insurance	104,975
Vocational Rehabilitation Administration fund	Vocational Rehabilitation Administration – Business-type Fund	144,893
		$ 16,430,758

NOTE 6 - INTER-FUND AND INTRA-ENTITY TRANSACTIONS (CONTIINUED)

Transfers from (to) other funds for the year ended June 30, 2017 are as follows:

Transfer or Fund	Purpose	Amount
Unemployment Insurance	Cash for work incentives and administrative expenses payments	$ 42,074,434
Unemployment Insurance	Cash for administrative expenses payments	1,779,888
Disability Insurance	Surplus cash for administrative expenses payments	1,400,000
Other Governmental Funds	Indirect costs allocation	1,929,402
Work Opportunity Incentive Fund	Surplus cash for administrative expenses payments	12,197,689
General Fund	Surplus cash for administrative expenses payments	750,000
Vocational Rehabilitation Administration fund	Cash transfer to central government	229,050
Vocational Rehabilitation Administration Business-type Fund	Cash transfer to central government	91,929
		$ 60,452,392

.The principal purpose of the inter-fund transfers was the unemployment insurance fund's distribution of surplus cash belonging to the Work Opportunity Incentive Fund and the General Fund for the payment of work incentives and administrative expenses amounting to $43.9 million as required by law.

Inter-fund receivables and payables represent pending settlements of the aforementioned transfers or transactions from current and prior years.

Due to/from other governmental entities by the **Department** at June 30, 2017 in the amount of $13.75 million, consists mainly of utilities costs pending for payment.

NOTE 7 - RESTRICTED ASSETS

Restricted assets included in the **Department's** basic financial statements as of June 30, 2017 consist of restricted cash, receivables, notes receivables, and investments held for unemployment and disability insurance benefits payments in the business-type activities amounting to approximately $655 million.

Notes receivable from restricted assets of the **Department** included in the basic financial statements as of June 30, 2017 consist of Tax Revenue Anticipation Notes "TRANS" from the Commonwealth of Puerto Rico for $15 million. On July 14, 2016, Act No. 69-2016 was enacted by the Commonwealth of Puerto Rico. Each fiscal year, the Commonwealth issues TRANS, so that the Commonwealth, in its cash flow management program designed to maximize the use of moneys in the General Fund, will have an alternate means of providing a liquidity mechanism to cover any temporary cash shortages projected for a fiscal year. TRANS are a type of short term financing, which are repaid during the last quarter of the fiscal year.

NOTE 7 - RESTRICTED ASSETS (CONTIINUED)

The Act No. 102-2015 amended certain existing laws such that certain governmental entities, such as the DTRH, can acquire TRANS from the Commonwealth Act No. 69-2016 was enacted to authorize the DTRH, among other governmental entities, to acquire TRANS in the aggregate amount of $400 million during fiscal year 2016-2017. Pursuant to the Act the DTRH was authorized to acquire $15 million in TRANS from the Commonwealth during fiscal year 2016-2017. The TRANS should generate a return (6% interest per annual) equal or greater than the average investment return of the DTRH.

Liabilities payable from restricted assets of the **Department** included in the basic financial statements as of June 30, 2017 mainly consist of unemployment and disability insurance benefits payable in the business-type activities amounting to approximately $50.1 million.

Restricted net position of the **Department** included in the basic financial statements as of June 30, 2017 consist of net position for payment of unemployment and disability insurance benefits in the business-type activities amounting to approximately $563 million.

NOTE 8 - CAPITAL ASSETS

Capital assets activity of the **Department** for the fiscal year ended June 30, 2017 was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Governmental Activities:				
Capital assets, being depreciated:				
Buildings	$ 7,535,000	$ -	$ -	$ 7,535,000
Furniture and equipment	17,309,218	116,829	-	17,426,047
Vehicles	139,905	-	-	139,905
Total capital assets, being depreciated	24,984,123	116,829	-	25,100,952
Less accumulated depreciation for:				
Buildings	1,318,626	251,167	-	1,569,793
Furniture and equipment	15,305,237	702,092	-	16,007,329
Vehicles	133,816	6,089	-	139,905
Total accumulated depreciation	16,757,679	959,348	-	17,717,027
Governmental activities capital assets, net	$ 8,226,444	$ (842,519)	$ -	$ 7,383,925

NOTE 8 - CAPITAL ASSETS (CONTINUED)

	Beginning Balance	Additions	Retirements	Ending Balance
Business-type Activities:				
Capital assets, being depreciated:				
Buildings	$ 450,153	$ -	$ -	$ 450,153
Furniture and equipment	335,006	5,897	-	340,903
Computer, equipment and software	108,318	-	-	108,318
Vehicles	213,224	-	-	213,224
Total capital assets, being depreciated	1,106,701	5,897	-	1,112,598
Less accumulated depreciation for:				
Buildings	313,683	43,280	-	356,963
Furniture and equipment	307,013	16,463	-	323,476
Computer, equipment and software	108,318	-	-	108,318
Vehicles	186,135	24,119	-	210,254
Total accumulated depreciation	915,149	83,862	-	999,011
Business-type activities capital assets, net	$ 191,552	$ (77,965)	$ -	$ 113,587

Depreciation expense was charge to the functions/programs of the **Department** for the year ended June 30, 2017 as follows:

Governmental activities:	
General and administrative	$ 9,629
Employment regulations	69,947
Employment services	344,365
Unemployment services	10,189
Work incentive	306,044
Occupational safety and health	2,251
General and administrative VRA	216,923
Total depreciation expense-governmental activities	$ 959,348
Business-type activities:	
Vocational Rehabilitation Administration	$ 49,655
Disability Insurance	34,207
Total depreciation expense-business-type activities	$ 83,862

The **Department** follows the provisions of GASB Statement No. 42, "*Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries - an amendment of GASB Statement No. 34*". This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. The **Department** did not recognize any impairment loss during the fiscal year ended June 30, 2017.

NOTE 8 - CAPITAL ASSETS (CONTINUED)

As discussed in **Note 1** to the financial statements, on November 14, 2011, the Reorganization Plan Number 9 merged and transferred all the operations, personnel, assets, functions and powers of the FEWTA to the Department. Part of the assets transferred consisted of eighteen (18) buildings acquired by FEWTA either by virtue of law or donation. As of the date of the financial statements, fourteen (14) of the properties were appraised and the fair value was recognized in the financial statements of the **Department**. The remaining four (4) buildings have not been appraised, and, therefore, a fair value could not be determined and could not be recorded in the financial statements of the **Department** as of the end of the fiscal year.

NOTE 9 – UNEARNED REVENUES

Total unearned revenues as of June 30, 2017 amounted to $21,018,321, and are presented in the following business-type funds:

Business-type activities:	
Unemployment Insurance	$ 19,405,026
Disability Insurance	1,598,898
Drivers' Insurance	14,397
Total depreciation expense-business-type activities	$ 21,018,321

NOTE 10 - LONG-TERM LIABILITIES

Long-term liabilities activity of the **Department** for the fiscal year ended June 30, 2017 was as follows:

	Beginning Balance	Increase (Decreases)	Ending Balance	Due within one year	Long-term portion
Governmental activities:					
Compensated absences	$ 22,870,685	$ (7,125,464)	$ 15,745,221	$ 7,098,927	$ 8,646,294
Christmas bonus	1,365,151	(504,187)	860,964	860,964	-
Early Retirement Program	5,985,621	(759,407)	5,226,214	826,001	4,400,213
Total governmental activities	30,221,457	(8,389,058)	21,832,399	8,785,892	13,046,507
Business-type Activities:					
Compensated absences	1,854,478	(308,043)	1,546,435	631,394	915,041
Total	$ 32,075,935	$ (8,697,101)	$ 23,378,834	$ 9,417,286	$ 13,961,548

Compensated Absences

Long-term debt includes approximately $17.3 million of accrued vacation and sick leave benefits at June 30, 2017. The total liability of compensated absences recorded as governmental and business-type activities amounted to approximately $15.7 and $1.5 million, respectively.

NOTE 10 - LONG-TERM LIABILITIES (CONTINUED)

Christmas Bonus

Long-term debt includes approximately $861 thousand of accrued Christmas bonus at June 30, 2017 recorded in the governmental activities. The accrued Christmas bonus for business-type activities amounted to approximately $103.7 thousand, which was recorded as part of accounts payable and accrued expenses in the enterprise funds' financial statements.

NOTE 11 - PENSION PLAN BENEFITS

General information about the pension plan

The **Department** is a participating employer in a retirement plan administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covered all regular full-time public employees working for the executive and legislative branches of the Commonwealth and the municipalities of Puerto Rico (including mayors); the firefighters and police of Puerto Rico and employees of certain public corporations not having their own retirement systems. Prior to July 1, 2013, the system operated under the following benefits structures:

- Act No. 447 of May 15, 1951 ("Act 447") effective on January 1, 1952 for members hired up to March 31, 1990,
- Act No. 1 of February 16, 1990 ("Act 1") for members hired on or after April 1, 1990 and ending on or before December 31, 1999,
- Act No. 305 of September 24, 1999 (which amended Act 447 and Act 1) for members hired from January 1, 2000 up to June 30, 2013.

Employees under Act 447 and Act 1 are participants of a cost-sharing multiple employer defined benefit plan. Act 305 members are participants under a pension program known as System 2000, a hybrid defined contribution plan. Under System 2000, there was a pool of pension assets invested by the System, together with those of the current defined benefit plan. Benefits at retirement age were not guaranteed by the Commonwealth and were subjected to the total accumulated balance of the savings account. Effective on July 1, 2013, Act No. 3 of 2013 ("Act 3") amends the provisions of the different benefits structures under the ERS. Act 3 moves all participants (employees) under the defined benefit pension plans (Act 447 and Act 1) and the defined contribution plan (System 2000) to a new defined contribution hybrid plan. Contributions are maintained by each participant in individual accounts. Credits to the individual accounts include: (1) retirement benefits accrued and savings account balances under the provisions of Act 447, Act 1 and System 2000 as of June 30, 2013; (2) contributions made by all members of ERS after June 30, 2013; and, (3) the investment yield for each semester of the fiscal year.

NOTE 11 - PENSION PLAN BENEFITS (CONTINUED)

Benefits provided

Eligibility for retirement: Act 3 establishes the following retirement eligibility requirements: (1) Act 447 regular employees upon attaining a range between 59 to 61 years (depending of date of birth) and 10 years of creditable service, (2) Act 1 employees upon attaining 55 years with 30 years of creditable service, (3) System 2000 regular employees upon attaining a range between 61 to 65 years (depending of date of birth) and, (4) Act 3 employees hired after July 1, 2013 upon reaching 67 years. High risk employees (state and municipal police, firefighters and custody officials) under Act 447 and Act 1 will be eligible at 55 years with 30 years of creditable service; for System 2000 employees at 55 years of service and for Act 1 employees hired after July 1, 2013 upon reaching 58 years.

Accrued benefits: All members are entitled to a lifetime annuity based on the balance of the deferred contribution individual account at the time of the retirement calculated based on a factor that will incorporate the individual's life expectancy and a rate of return. For Act 447 and Act 1 active participants, all retirement benefits accrued through June 30, 2013 were frozen, and thereafter, all future benefits accrue under Act 3 plan.

These participants will receive a pension at retirement age equivalent to what they have accrued under Act 447 and Act 1 up to June 30, 2013 plus the lifetime annuity corresponding to contributions made to the individual account after July 1, 2013 as described above. Act 447 participants, except police and mayors, may elect to coordinate coverage with Social Security benefits ("Coordinated plan"). Under this option, participants are subject to a benefit recalculation upon attainment of the Social Security Retirement Age. For all members, if the balance of the defined contribution individual account is less than $10,000 the amount shall be paid as a lump sum instead of an annuity. Effective July 1, 2013, the minimum monthly pension amount for members who retired or disabled before July 1, 2013 is $500.

Termination benefits: Members are eligible to a lump sum payment of the defined contribution individual account as of the date of the permanent separation of service upon termination of service prior to 5 years of service or if the balance of the defined contribution individual account is less than $10,000.

Deferred retirement: Members are eligible at the applicable retirement eligibility age to a lifetime annuity based on the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) upon termination of service with 5 or more years of service (10 years of creditable service for Act 447 and Act1 members) but prior to the applicable retirement eligibility, provided the member has not taken a lump sum withdrawal from the defined contribution individual account.

NOTE 11 - PENSION PLAN BENEFITS (CONTINUED)

Benefits provided (Continued)

Death benefits: For non-retired members, their designated beneficiaries will receive a refund of the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members). For pensioned members retired prior to June 30, 2013, the annual income to a widow or widower or dependent children is equal to 60% of the retirement benefit payable for life for a surviving spouse or disabled children and payable until age 18 or age 25 if pursuing studies for non-disabled children. For pensioned members retired after June 30, 2013, payments to beneficiaries will be the excess, if any, of the balance of the deferred contribution individual account plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) over the total annuity payments paid to the member and any beneficiaries.

Disability benefits: Members who are permanently separated from service due to total and permanent disability, due to disability pursuant to Act No. 127 of June 27, 1958, as amended, or due to terminal illness, as determined by the Administrator, shall be entitled to the balance of the deferred contribution individual account in a lump sum, or through the grant of an annuity, or any other optional form of payment pursuant to Section 5-110 of Act No. 447, at the option of the participant, plus the accrued benefit as of June 30, 2013 (for Act 447 and Act 1 members) at the applicable retirement eligibility age.

Beginning on June 30, 2013, no disability pensions shall be awarded pursuant to Sections 2-107 thru 2-111 of Act No. 447. A disability benefits program is established 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 Office of the Commissioner of Insurance 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 participant.

Special laws and pensioner additional benefits: The Center is required to cover other retirement benefits of its retired employees (if retired prior to July 1, 2013) as required by Commonwealth's laws, including: (1) various special laws – ad-hoc cost of living allowance adjustments (COLA) provided in prior years; (2) various special laws –additional minimum pension benefits and, (3) Act 3 retired pensioners "Additional Benefits Program". All of these other retirement benefits are applicable only to employees who retired prior to July 1, 2013 under Act 447 and Act 1. The "Additional Benefits Program" includes: (1) a medication bonus of $100 per member which shall be paid no later than July 15 of each year; (2) a Christmas bonus of $200 per member which shall be paid no later than December 20 of each year and, (3) a matching share of $1,200 for healthcare insurance plan. These healthcare benefits are provided through insurance companies whose premiums are paid by the retired employees with the matching share financed by the Center.

NOTE 11 - PENSION PLAN BENEFITS (CONTINUED)

Contributions

The Act No. 3 is the authority under which obligations to contribute to the Plan by the Plan members, employers and other contributing entities are established or may be amended. Contribution rates are not actuarially determined.

Members: All participants are required to contribute 10% of gross salary. Members may voluntarily make additional contributions to their defined contribution individual account.

Payroll-based employer contribution: The **Department** contributed 15.525% of gross salary for fiscal year 2016-2017. Act 3 requires an additional 1.25% annually for each of the following three years, reaching an aggregate contribution rate of 20.525% effective July 1, 2020. The **Department** contributed $10.8 million during fiscal year 2016-2017. These amounts represented the 100% of the required contribution for the corresponding year.

Additional Uniform Contribution: To improve the liquidity and solvency of the ERS, the Commonwealth enacted Act No. 32 of 2013, which amended Act 447 to provide for an Additional Uniform Contribution ("AUC"). The AUC will be financed by all participating employers (including the **Department**) of the ERS. Beginning with the 2014-2015 fiscal year until the 2032-2033 fiscal year, the AUC will be the uniform contribution certified by the external actuary of the ERS at least 120 days prior to the start of each fiscal year, as necessary to avoid having the projected gross assets of the ERS, during any subsequent fiscal year, to fall below $1,000,000,000. Each entity covered by this Act is directly responsible for the payment of their corresponding certified AUC. However, for any fiscal year, the OMB will consign in the Commonwealth's General Budget enough resources to subsidy totally or partially the AUC certified to any public corporation, municipality or governmental entity, including the Judiciary Branch, whose operating expenditures are not fully or partially covered by the General Budget and for which the OMB has subsequently determined it does not have the financial capacity to assume such obligation during the fiscal year. Therefore, the **Department** did not pay any AUC during the fiscal year 2017. As explained in **Note 16**, on August 23, 2017, Act No. 106 establishes the pay as you go method that identifies the General Fund as the source of funding for future pension payments when System assets are fully depleted. Such method recognizes that the government will directly pay pension benefits as they are due rather than attempt to build up assets in a trust to pre-fund future benefits.

Disability insurance: As described above, a disability benefits program is established which shall provide a temporary annuity in the event of total and permanent disability. All members shall mandatorily contribute to a disability insurance established by Act 3 for which participants shall have to contribute such sums, fixed in dollars or a percent of the salary determined by the ERS. The contribution required is equal to or less than .25% of the participant's salary. This contribution shall not be credited to the participant's deferred contribution individual account.

NOTE 11 - PENSION PLAN BENEFITS (CONTINUED)

Contributions

Special laws and pensioner additional benefits: These other retirement benefits are funded on a pay-as-you-go basis and billed by ERS to the **Department** at the beginning of each fiscal year. As required by Act 3, the invoice includes a supplemental contribution of $2,000 per pensioner to finance the Additional Benefits Program. Commonwealth laws provide for a subsidy of this obligation, applicable to all participating employers (including the **Department**) of the ERS that the Puerto Rico Office of Management and Budget ("OMB") determines do not have financial capability to pay these other retirement benefits obligation. For the year ended June 30, 2017 the cost related to these post-employment benefits amounted to $759.4 thousand.

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

As per the requirements of the GASB Statements No. 67 and 68, ESR is required, as the pension plan's administrator, to provide to each of its participating employers audited actuarial and financial information used in the calculation of their proportionate share of the plan's net pension liability, pension expense and deferred outflows/inflows of resources related to pensions as of the measurement date.

For the fiscal year ended June 30, 2017, the measurement date is June 30, 2016. In addition, the ESR has to provide all the required actuarial and historical data to be reported in the notes to the financial statements of the **Department** and as Required Supplementary Information (RSI).

However, as indicated in the Basis for Qualified Opinion on the Governmental Activities section of the independent auditors' report, the ESR has not provided to the **Department** the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability as of June 30, 2017. As a result, management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68.

The effects of this departure from U.S. generally accepted accounting principles in the assets, liabilities, deferred outflows/inflows of resources and net position of the Department's governmental activities cannot be determined at this time.

NOTE 12 - VOLUNTARY TERMINATION BENEFITS PROGRAM

On July 2, 2010, the Commonwealth enacted Act. No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the Vocational Rehabilitation Administration. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited services in the Retirement System and will consist of biweekly benefits ranging from 37.5% to 50% of each employee's salary, as defined. In this early retirement benefit program, the Vocational Rehabilitation Administration will make the employer contributions to the Retirement System and pay the corresponding pension until the employee complies with the requirements of age and 30 years of credited service in the Retirement System.

The Economic incentives are available to eligible employees who have less than 15 years of credit services in the Retirement System or who have at least 30 years of credited service in the Retirement System and the age for retirement or who have the age for retirement. Also, the economic incentives will consist of a lump-sum payment ranging from one-month to six-month salary based on employment years. Additionally, eligible employees that choose to participate in the early retirement benefit program or that choose the economic incentive and have less than 15 years of credited service in the Retirement System are eligible to receive health plan coverage for up to 12 months in a health plan selected by management of the Administration.

On December 8, 2015, the Commonwealth enacted Act No. 211, establishing a voluntary program that provides benefits for pre-retirements to eligible employees, as defined by the Act. Such program applies to eligible employees of agencies and component units whose budgets are funded in whole or in part by the Commonwealth's General Fund, municipalities, component units that operate with their own resources (except those that have their own retirement system), Judiciary Branch, except judges, and the Commonwealth Employees Association. Act No. 211, among other provisions, established that pre-retirement benefits (preretirement program) will be provided to eligible employees who started contributing to the System before April 1, 1990 with at least 20 years of service and will consist of bi-weekly benefits of 60% of the of each employee's salary as of December 31, 2015. Pursuant to the Act, the employers will continue making the applicable employee and employer contributions to the Retirement System and the employer contributions to the Federal Social Security and Medicare based on such average salary as of December 31, 2015.

Individual contributions to the Federal Social Security and Medicare will be deducted from the bi-weekly benefits to be paid to the participant. These payments will be made until the employee reaches the age of 61 years. Other benefits would include the payment of the participant's healthcare plan during the first two years of the program.

Once the participant reaches age of 61 years, the participant is eligible to receive payments from the System and is entitled to a guaranteed minimum pension of 50% of their average salary (except police officers, which would be paid 60%) whose related costs will be paid by the employer.

NOTE 13 - COMMITMENTS

The **Department** has several non-cancelable operating leases, including those with the Public Buildings Authority of the Commonwealth of Puerto Rico (PBA), primarily for regional **Department's** facilities that expire over minimum terms of five years, and can be renewed for additional terms, as provided in each contract. Annual rental payments to the PBA are determined based on the debt service requirements of the related debt to be paid with the rental proceeds, plus the facilities operating costs allocation. For the year ended June 30, 2017, rent expenditures of the **Department** amounted to approximately $9.8 million under such operating leases.

The future minimum lease payments for these leases are as follows:

Year ending June 30, 2017	Amount
2018	$ 6,308,797
2019	5,906,544
2020	5,215,441
2021	3,591,612
2022	3,182,143
Thereafter	5,487,300
	$ 29,691,837

NOTE 14 - CONTINGENCIES

Litigations

The **Department** is a defendant or co-defendant in various pending litigations. The **Department's** management, after consultation with in-house legal counsel, has determined that the probable outcome of these cases will not have a material impact on the accompanying basic financial statements. The Commonwealth of Puerto Rico Act 104 of June 30, 1955, as amended, known as Claims and Lawsuits against the State, provides that lawsuits initiated against an agency or instrumentality of the Commonwealth, present and former employees, directors, mayors, and others may be represented by the Department of Justice of the Commonwealth of Puerto Rico. Any adverse claim to the defendants will be paid by the General Fund of the Commonwealth. However, the Secretary of the PR Treasury has the discretion of requesting reimbursement of the funds expended for these purposes from public corporations, governmental institutions and municipalities.

NOTE 14 – CONTINGENCIES (CONTINUED)

Federal Awards

The **Department** participates in federal programs received from the USDOL, USDE and USEEOC to promote the working-class welfare and finance the administration costs of its various federal programs. Expenditures financed by federal grants are subject to program compliance audits by the grantor agencies in order to assure compliance with grant requirements. If expenditures are disallowed due to noncompliance with grant program requirements, the **Department** may be required to reimburse the grantor agency. Accordingly, the Department's compliance with applicable grant requirements will be established at a future date. Nevertheless, the **Department's** management is of the opinion that the amount of expenditures, which may be disallowed by the granting agencies from such audits, will be immaterial to the **Department's** basic financial statements.

Puerto Rico Fiscal Agency and Financial Advisory Authority – Act No. 2 of 2017

On January 18, 2017, the Commonwealth of Puerto Rico approved Act No. 2 "The Puerto Rico Fiscal Agency and Advisory Authority (FAFAA)" in order to empower the Authority to oversee compliance with the certified budget and fiscal plan approved pursuant to the Puerto Rico Oversight, Management and Economic Stability Act of 2016 (PROMESA); to delegate to the Authority the power to revise matters including, but not limited to, agreements, transactions and regulations of the agencies and instrumentalities of the Government of Puerto Rico; to provide that it shall be the only entity authorized to enter into creditors' agreement, and/or renegotiate or restructure the public debt, in whole or in part, or any other debt issued by any Government body including, but not limited to, agencies, boards, commissions, instrumentalities, public corporations or applicable political subdivision; to provide that the Executive Director of the Authority shall be the legal successor of the President of the Government Development Bank for Puerto Rico (GDB) in every Board, Committee, Commission or Council; to repeal Chapter 6 of Act No. 21-2016, as amended, and the Puerto Rico Fiscal Oversight and Recovery Organic Act, Act No. 208-2015; and for other related purposes.

The FAFAA will act as fiscal agent, financial advisor and reporting agent of all entities of the Government of Puerto Rico. It shall be the governmental entity responsible for the collaboration, communication and cooperation between the Government of Puerto Rico and the Fiscal Oversight Board created under PROMESA. To such effect, the FAFAA is empowered to collaborate in conjunction with the Governor of Puerto Rico and his representatives in the creation, execution, supervision and oversight of any Fiscal Plan and any Budget as defined by the terms of PROMESA. In addition, the Authority shall be the government entity charged with supervising, executing and administering the Fiscal Plan approved and certified in accordance with PROMESA and shall ensure that all the entities of the Government of Puerto Rico comply with the approved Fiscal Plan. In addition, the FAFAA shall assume all fiscal agency, financial advisory and reporting functions of the GDB under Act No. 272 of May 15, 1945, as amended. It shall oversee all matters related to the restructuring, renegotiation or adjustment of any existing or future obligation, and the liability management transactions for any existing or future obligation of the Government of Puerto Rico.

NOTE 14 – CONTINGENCIES (CONTINUED)

Puerto Rico Fiscal Agency and Financial Advisory Authority – Act No. 2 of 2017 (Continued)

The Authority shall be governed by Board of Directors composed of five (5) members, including the Executive Director of the FAFAA, appointed by the Governor, one (1) representative of the Senate of the Puerto Rico, and one (1) representative of the House of Representatives of Puerto Rico, who shall be designated by the Presiding Officer of each Legislative House. The remaining two members shall be appointed by the Governor.

Puerto Rico Financial Emergency and Fiscal Responsibility Act – Act No. 5 of 2017

On January 29, 2017, the Commonwealth of Puerto Rico approved Act No. 5 "Puerto Rico Financial Emergency and Fiscal Responsibility Act" to facilitate and encourage a voluntary negotiation process under PROMESA between the Governor and/or the FAFAA, on behalf of the Government of Puerto Rico, and the creditors of the Government of Puerto Rico and its instrumentalities.

This Act authorizes the Government of Puerto Rico, within the parameters established by PROMESA, to designate certain services necessary for the health, safety and welfare of the residents of Puerto Rico and provided by the Government of Puerto Rico and its instrumentalities as "essential services", in accordance with the Constitution of Puerto Rico. This Act amends and repeals portions of the Puerto Rico Emergency Moratorium and Financial Rehabilitation Act, Act No. 21-2016, as amended by Act No. 40-2016 and Act No. 68-2016 (the "Moratorium Act") and of certain Executive Orders issued by then Governor of Puerto Rico Hon. Alejandro García Padilla that provided for emergency periods and a temporary stay of litigation, thus negating the timely payment of the Government's obligations and the initiation of a voluntary negotiation process with the creditors of the Commonwealth and its instrumentalities. It also suspends or cancels, or both, all special appropriations not budgeted in the fiscal year 2016-17 that may have been multi-year authorizations from prior fiscal years.

The Emergency Period will begin with the effective date of this Act and end in May 1, 2017, and may be extended by the Governor pursuant to an executive order for one additional period of three (3) months. During the Emergency Period declared by this Act, the Governor has the power to designate services provided by the Commonwealth and its instrumentalities as essential services or services that are not essential services and utilize available resources to provide for the satisfaction of obligations of the Commonwealth and its instrumentalities, while also recognizing the need to provide for the services essential to the health, safety and welfare of the residents of Puerto Rico.

The Governor shall pay debt service to the extent a) possible after all essential services of the Commonwealth have been provided for; or b) ordered to do so by the Oversight Board or any board created under federal law. In addition, the Governor may issue executive orders requiring the use of available resources to be deposited in a lockbox account under the sole control of the FAFAA to pay for essential services as he deems necessary to protect the health, safety and welfare of the residents of Puerto Rico; and he may take all actions deemed reasonable and necessary to preserve the ability of the Commonwealth or an instrumentality of such to continue providing essential services.

NOTE 14 - CONTINGENCIES (CONTINUED)

Puerto Rico Financial Emergency and Fiscal Responsibility Act – Act No. 5 of 2017 (Continued)

To that end, the Governor may issue executive orders establishing priority rules for the disbursement of public funds when resources available for a fiscal year are insufficient to cover the appropriations made for the fiscal year. Notwithstanding Section 4(c) of Act No. 147 of June 18, 1980, as amended, the Governor may reprioritize services and expenses described in Section 4(c)(3) to a higher payment priority than as listed in Section 4(c). Finally, the Governor may issue executive orders as he deems necessary or advisable to assure the payment of a debt obligation of the Commonwealth or an instrumentality of such.

With regards to the emergency measures related to the Government Development Bank (GDB), the Governor may take any actions he deems reasonable and necessary to permit the GDB to continue carrying out its operations, including 1) prescribing such conditions or restrictions for the conduct of the business of the GDB, including dispensing with the compliance, in whole or in part, of any requirement prescribed by otherwise applicable law (i.e. the requirement of maintaining deposit reserves levels); 2) ordering the limitation, postponement or suspension of any payment, in whole or in part, of any obligation pursuant to terms the Governor prescribes to address the GDB's liquidity needs or facilitate its ability to carry out its operations; 3) suspending payments on any obligation guaranteed by the Bank, on any letter of credit and on any obligation or commitment to lend or extend money or credit; 4) taking any action with respect to the GDB as provided for in Act No. 17 of September 23, 1948, as amended, or Act No. 22 of July 24, 1985, as amended, as applicable; and 5) delegating to the Bank, its Board or its employees authority to take actions in furtherance of these emergency measures.

If any restriction is placed on disbursements made by the GDB regarding these measures, the Bank shall not, without the authorization of the Governor, 1) disburse any loans or credit facility; 2) honor requests to withdraw or transfer any deposit, including by check or other means, of an agency, public corporation or instrumentality of the Commonwealth (other than those listed in point three (3)); 3) subject to the availability of funds and the aggregate disbursements established by the Governor, honor any request to withdraw or transfer any deposit held by, or request to honor any check written by, the Legislative and Judicial Branches, the University of Puerto Rico, the Office of the Comptroller, the Office of the Electoral Comptroller, the State Elections Commission, the Government Ethics Office, the Independent Prosecutors Panel, or a Municipality of the Commonwealth, provided, however, than an authorized officer of the requesting entity certifies along with supporting documentation that such funds will be used for the payment of essential services.

If any restriction is placed on disbursements from the GDB, then any value disbursed to a creditor after such restriction is imposed shall be subtracted from the value of any distribution that such creditor is entitled to receive, as of the first date of the restriction, if the GDB is subsequently liquidated or placed into a receivership.

NOTE 14 - CONTINGENCIES (CONTINUED)

Fiscal Plan Submissions and Certifications – Commonwealth of Puerto Rico and Government Development Bank of Puerto Rico

On a letter dated January 18, 2017, the Financial Oversight and Management Board of Puerto Rico ("the Board") provided the Governor the fiscal plan targets and guidelines, on a category-by-category basis, that the certified plan should satisfy. Also, the Board approved the Governor's request that it extend the PROMESA stay on litigation through May 1, 2017 on conditions agreed to by the Governor, including a commitment not to attempt to procure short-term liquidity loans that could restrict fiscal options. On February 28, 2017, the Governor submitted a proposed fiscal plan and, after the review, analysis and deliberation with the Board's members, economists, consultants, attorneys and Governor's representatives, the Board informed the Governor on March 9, 2017 that it had determined the proposed fiscal plan did not satisfy PROMESA's requirements and recommended that certain revisions be made.

On March 11, 2017, the Governor submitted to the Board a revised proposed fiscal plan to address the identified violations in the prior proposed plan and, during the review process, further changes were incorporated into the Government's proposed plan.

On March 13, 2017, the Governor's final proposed fiscal plan was presented to the Board and, after its review and discussion, the Board approved and certified this final proposed plan with the following two (2) amendments:

- Implementation of a furlough program and the removal of all Christmas bonuses to achieve necessary liquidity and budgetary savings – The determination to implement these measures, in whole or in part, would be made on July 1 and September 1, 2017 based on the achievements by the Commonwealth of certain levels of savings and cash reserves through the right-sizing measures to be implemented in the proposed budget for the fiscal year 2017-18.

- An overhaul of the public pension systems that would provide for progressively reduced total pension outlays by 10% by fiscal year 2020.

The fiscal measures detailed in the certified fiscal plan were implemented by the approval on April 29, 2017 of Act 29 "Compliance with the Fiscal Plan Act". These measures are focused on four (4) major areas:

- Increase revenues by $1,380 million through tax and fees increases and better tax fiscalization procedures.

NOTE 14 - CONTINGENCIES (CONTINUED)

Fiscal Plan Submissions and Certifications – Commonwealth of Puerto Rico and Government Development Bank of Puerto Rico (Continued)

- Reduce expenditures by $1,623 million through 1) $434 million in payroll expenditure savings through the implementation of the "Single Employer Program" (an employee mobility plan), "freezing" of job vacancies and the uniformity of fringe benefits throughout the agencies (these measures do not apply to the University of Puerto Rico nor the Municipalities); 2) $439 million in efficiency savings though agencies consolidations, expenditure reductions and public-private alliances; 3) $750 million in subsidies reductions to the University of Puerto Rico, Municipalities, and other entities.

- Adjustments of $299 million in Health expenditures through the implementation of a new public healthcare model.

- An 80% reduction on debt service payments.

On March 13, 2017, the Government Development Bank for Puerto Rico submitted its proposed fiscal plan to the Financial Oversight and Management Board and it was certified on April 28, 2017. This plan contemplates an orderly wind down of its operations within a three-to-four years' period (by fiscal year 2021).To efficiently effectuate this process, the GDB's management has created a Project Management Office ("PMO") for the smooth transition of the Bank's current operations.

The main objectives of this fiscal plan are as follows:

- All fundamental new business banking and origination activities will have ceased.

- Service the existing loan portfolio through maturity or refinancing by third party financial institutions.

- Coordinate and execute all possible collection efforts on loans held by the GDB and collateral supporting the loans, when applicable.

- Formalize the process for a transparent and orderly sale of real estate assets at fair market value.

- Restructure the GDB's workforce through the "Single Employer Program" and voluntary incentivized separation program.

NOTE 14 - CONTINGENCIES (CONTINUED)

Fiscal Plan Submissions and Certifications – Commonwealth of Puerto Rico and Government Development Bank of Puerto Rico (Continued)

On May 3, 2017, the Financial Oversight and Management Board for Puerto Rico approved and certified the filing in the United States District Court for the District of Puerto Rico of a voluntary petition under Title III of PROMESA for the Commonwealth of Puerto Rico. This filling was necessary due to the expiration on May 1, 2017 of the stay against litigation provided by PROMESA, and thus making the government vulnerable to lawsuits by its creditors.

The voluntary filing under Title III would preclude those lawsuits while allowing the possibility of consensual negotiations to continue. Also, on May 5, 2017 another voluntary petition under Title III of PROMESA was approved, certified and filed for the Puerto Rico Sales Tax Financing Corporation ("COFINA"), and on May 22, 2017, the Board approved, certified and filed similar voluntary petitions for the Puerto Rico Highway and Transportation Authority ("HTA") and the Government of Puerto Rico Employees Retirement System ("ERS"). Also, on July 1, 2017 the members of the Oversight Board of POMESA unanimously authorized the Puerto Rico Power Authority (PREPA) to file bankruptcy under the provisions of Title III of PROMESA. Accordingly, on July 2, 2017, PREPA filed bankruptcy in the United States District Court of Puerto Rico.

NOTE 15 - GOING CONCERN CONSIDERATION

As a part of its formal activities, and as disclosed in **Note 1**, the **Department** is financially dependent of Commonwealth appropriations. As of June 30, 2017, 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. Because of budgetary constraints, the financial support that the Commonwealth has provided to the **Department** may be affected in the near future. The **Department** has evaluated the possible effects of the budgetary constraints and liquidity risks being faced by the Commonwealth on its basic financial statements and operations and has concluded that, as of June 30, 2017, the **Department** will continue to operate as a going concern for a period not less than twelve months after such date.

NOTE 16 - SUBSEQUENT EVENTS

The **Department** evaluated subsequent events through June 28, 2018, the date on which the financial statements were available to be issued to determine if such events should be recognized or disclosed in the 2017 financial statements.

NOTE 16 - SUBSEQUENT EVENTS (CONTINUED)

On June 23, 2017, the Legislature approved a Joint Resolution for the Fiscal Year 2017-2018, which among other things, ordered the Retirement System to liquidate their assets and pass the net proceeds to the Treasury Department of the Commonwealth. Moreover, on August 23, 2017, the Governor of Puerto Rico signed into law the Act for Guaranteeing the Payment to Retirees and Establishing a New Defined Contributions Plan for the Public Servicers (Act No. 106-2017). Such Act establishes the pay as you go method that identify the General Fund as the source of funding for future pension payments when System assets are fully depleted. Such method recognizes that the government will directly pay pension benefits as they are due rather than attempt to build up assets in a trust to pre-fund future benefits. In that way, the Act allows the System to continue to pay benefits even after System assets have been exhausted. The Act also terminates the Hybrid Program for the System participants as of June 30, 2017. The members of the Hybrid Program and new System members hired since July 1, 2017 will be enrolled in a new defined contribution program that will be selected by the Retirement Board.

On December 18, 2017, Act No. 122 known as the Puerto Rico New Government Act was enacted. This Act allows the Governor of Puerto Rico to maximize the resources and personnel of the Executive Branch through the transfer, consolidation, reorganization, outsourcing and creation of new and more efficient governmental structures and agencies. Because of the Act, the Reorganization Plan Number 2 of January 18, 2018, creates the Secretary of Labor Relations, which will transfer all legal litigations from the Public Service Appellate Commission, the Labor Relations Commission and the Investigation, Prosecution and Appeals Commission to the **Department**.

On September 6, 2017 Hurricane Irma passed north of Puerto Rico and then on September 20, 2017 Puerto Rico got a direct hit from Hurricane Maria. Due to the devastation caused, the Commonwealth's Central Government and some of its instrumentalities would face severe cash shortfalls from lower revenues, higher costs and delayed or reduced cost-saving measures that had been required by the Puerto Rico's Fiscal Plan previously approved. Due to the impact of such hurricanes, the **Department** suffered significant losses in some of its properties. Although the **Department** does not have an emergency fund established to recover for such hurricane impact, the **Department** expects to recapture from the insurance company and FEMA the amounts completely needed to reestablish the state of its properties as before the passing of these hurricanes.

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
BUDGETARY COMPARISON SCHEDULE - GENERAL FUNDS
For the Year Ended June 30, 2017

	Original Budget	Final Budget	Actual Amount in Budgetary Basis	Variance Favorable (Unfavorable)
Revenues:				
Legislative appropriations	$ 28,560,160	$ 28,407,358	$ 28,407,358	$ -
Total revenues	28,560,160	28,407,358	28,407,358	-
Expenditures:				
General and administrative	14,264,330	14,111,528	12,374,138	1,737,390
Rehabilitation services	14,295,830	14,295,830	14,775,331	(479,501)
Total expenditures	28,560,160	28,407,358	27,149,469	1,257,889
Excess of revenues over expenditures	$ -	$ -	$ 1,257,889	$ 1,257,889

See accompanying notes to the budgetary comparison schedule.

NOTE 1 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgetary Control

The **Department's** annual budget is prepared on the budgetary basis of accounting, which is not in accordance with US GAAP, and represents fund, function and department appropriations submitted by the Secretary of Labor to the Puerto Rico Office of Management and Budget (PROMB). Such budget is incorporated by the PROMB into the Commonwealth consolidated annual budget document, which is submitted by the Governor to the Legislature, and then approved by the Legislature prior to the beginning of the fiscal year. Amendments to the budget require the approval of the Legislature. Transfers of certain appropriations within the budget require the approval of the PROMB and, after approval, accounted for by the PR Department of Treasury. Formal budget integration is employed as a management control device during the fiscal year for the general fund. As stated in the Constitution of the Commonwealth, the budgeted expenditures should be balanced with estimated revenues. The **Department** prepares its annual budget including the operations of the general fund. The annual appropriated budget for the fiscal year ended June 30, 2017 was $28.6 million.

For budgetary purposes, encumbrance accounting is used. The encumbrances (i.e., purchase orders, contracts) are considered expenditures when incurred. For US GAAP reporting purposes, encumbrances outstanding at year-end are reported as assignments of fund balances and do not constitute expenditures or liabilities because the commitments will be honored during the subsequent year. The Commonwealth of Puerto Rico Accounting Act establishes that unassigned and unexpended funds at the end of the fiscal year from the **Department** should be reverted to the Secretary of the PR Treasury pursuant to Act 230.

Budget GAAP/Reconciliation

The following 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 US GAAP, a reconciliation of differences in the excess revenues over expenditures for the fiscal year ended June 30, 2017 is presented below:

NOTE 1 - STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY (CONTINUED)

Budget GAAP/Reconciliation

Sources of Resources:	
Actual amounts (Budgetary Basis) "Available for Appropriation" from the Budgetary Comparison Schedule	$28,407,358
Difference - Budget to GAAP:	
Perspective Difference:	
Non-budgetary items - Revenue of other funds	1,331,069
Total revenues – General Fund	$29,738,427
Uses of Resources:	
Actual amounts (Budgetary Basis) "Total Charges to Appropriation" from the Budgetary Comparison Schedule	$27,149,469
Difference - Budget to GAAP:	
Perspective Difference:	
Non-budgetary items - Expenditures of other funds	26,604,355
Timing Differences:	
Prior year encumbrances recorded as expenditures in the current year	(38,499)
Current year encumbrances not recorded as expenditures under the modified-accrual basis of accounting	373,978
Total expenditures – General Fund	$54,089,303

SINGLE AUDIT SECTION

COMMONWEALTH OF PUERTO RICO
DEPARTMENT OF LABOR AND HUMAN RESOURCES
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended June 30, 2017

Federal Grantor/Pass-through Grantor Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	From Pass-Through Awards	From Direct Awards	Total Expenditures
US Department of Agriculture					
Passed-through PR Department of Education					
National School of Lunch Program	10.555	018	$65,684	-	$65,684
Child and Adult Care Food Program	10.558	CC-038	9,141	-	9,141
Subtotal US Department of Agriculture			74,825	-	74,825
US Department of Housing and Urban Development					
Passed-through PR Department of Housing and Urban Development					
Public and Indian Housing	14.850	N/A	1,100	-	1,100
Subtotal US Department of Housing and Urban Development			1,100	-	1,100
US Department of Labor					
Direct Programs:					
Labor Force Statistics	17.002		-	672,738	672,738
Compensation and Working Conditions	17.005		-	88,138	88,138
Unemployment Insurance	17.225		-	137,395,758	137,395,758
Senior Community Service Employment Program	17.235		-	1,266,609	1,266,609
Trade Adjustment Assistance	17.245		-	223,975	223,975
Work Opportunity Tax Credit Program (WOTC)	17.271		-	78,503	78,503
Temporary Labor Certification for Foreign Workers	17.273		-	57,081	57,081
Occupational Safety and Health State Program	17.503		-	1,846,876	1,846,876
Total Direct Programs			-	141,629,678	141,629,678
Employment Services Cluster:					
Employment Service/Wagner-Peyser Funded Activities	17.207		-	7,419,671	7,419,671
Disabled Veterans' Outreach Program (DVOP)	17.801		-	261,839	261,839
Local Veterans' Employment Representative Program	17.804		-	220,524	220,524
Total Employment Services Cluster			-	7,902,034	7,902,034
Subtotal US Department of Labor			-	149,531,712	149,531,712
Equal Employment Opportunity Commission					
Direct Programs					
Employment Discrimination Title VII of the Civil Rights Act of 1964	30.001		-	453,687	453,687
Subtotal Equal Employment Opportunity Commission			-	453,687	453,687
Total Expenditures of Federal Awards			$75,925	$149,985,399	$150,061,324

See accompanying notes to the schedule of expenditures of federal awards.

NOTE 1 - BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grants activities of the **Department of Labor and Human Resources** (the **Department**) and is presented on the modified accrual basis of accounting. Therefore, some amounts presented in the Schedule may differ from amounts presented in or used in the preparation of the basic financial statements. The Schedule excludes the other agency, which is an organizational component of the Department, known as the Vocational Rehabilitation Administration, presented as governmental funds of the Department. The information in the Schedule is presented in accordance with the requirements of Uniform Guidance 2 CFR Part 200 *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance).

State or local governments redistributions of federal awards to the **Department** known as "pass-through awards", should be treated by the **Department** as though they were received directly from the federal government. The Uniform Guidance 2 CFR Part 200 requires the Schedule to include the name of the pass-through entity and the identifying number assigned to the pass-through entity for the federal awards received. Numbers identified as N/A are not available.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICES

A summary of the significant accounting policies used by the **Department** in the preparation of the Schedule follows:

a) The accompanying Schedule of Expenditures of Federal Awards is prepared from the **Department's** accounting records and is not intended to present the financial position or results of operations.

b) The financial transactions are recorded by the **Department** in accordance with the terms and conditions of the grant, which may not be consistent with generally accepted accounting principles in the United States of America.

c) Expenditures are recognized in the accounting period in which the liability is incurred, is measurable or when actually paid, whichever occurs first.

NOTE 3 - FEDERAL CFDA NUMBER

The Catalog of Federal Domestic Assistance (CFDA) numbers included in this Schedule are determined based on the program's name and the contract award year in the CFDA US Office of Management and Budget. The CFDA number is a program identification number, whose first two digits identify the federal agency or department that administers the program.

A cluster of programs means federal programs with different CFDA numbers that are defined as a cluster of programs, because they are closely related programs that share common requirements. The Schedule of Expenditures of Federal Awards includes the following clusters:

Cluster	Federal Program	Federal CFDA Number
Employment Service	Employment Service/Wagner-Peyser Funded Activities	17.207
	Disable Veterans' Outreach program (DVOP)	17.801
	Local Veterans' Employment Representative Program	17.804

NOTE 4 - MAJOR FEDERAL PROGRAMS

Major programs are identified in the Summary of Auditors' Results Section of the Schedule of Findings and Questioned Costs.

NOTE 5 - UNEMPLOYMENT INSURANCE

In accordance with the Department of Labor, Office of Inspector General instructions, the Department recorded State Regular Unemployment Compensation (UC) benefits under CFDA No. 17.225, on the accompanying Schedule of Expenditures of Federal Awards. The individual State and Federal portions are as follows:

State Regular UC benefits	$121,203,527
Federal UC benefits	1,438,319
Federal UC administrative costs	14,753,912
Total Benefits	$137,395,758

NOTE 6 - INDIRECT COST RATE

The **Department** has not elected to use the 10% de minims indirect cost rate allowed under the §200.414 Indirect (F&A) costs of the Uniform Guidance.

NOTE 7 - RECONCILIATION TO THE FUND FINANCIAL STATEMENTS

Expenditures of federal awards are reported in the **Department's** Statement of Revenues, Expenditures and Changes in Fund Balances (Deficit) - Governmental Funds and the Statement of Revenues, Expenses and Changes in Net Position - Enterprise Funds. A reconciliation of the total expenditures from the accompanying Schedule to the Fund Financial Statements is as follows:

Expenditures reported in the Statement of Revenues, Expenditures and changes in Fund Balance (Deficit) - Governmental Funds	$ 172,364,535
Expenses reported in the Statement of Revenues, Expenditures and Changes in Net Position - Enterprise Funds	135,490,092
Total	307,854,627
Less:	
General Fund	(54,089,303)
Work Opportunity Incentive Fund	(31,551,339)
Vocational Rehabilitation Administration	(61,548,140)
Indirect Costs Allocation	1,929,753
Disability Insurance	(8,382,250)
Drivers' Insurance	(4,152,024)
Amount reported in the Schedule of Expenditures of Federal Awards	$ 150,061,324

INDEPENDENT AUDITORS' 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 Secretary and Management of the
Commonwealth of Puerto Rico
Department of Labor and Human Resources
San Juan, Puerto Rico

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, business-type activities, each major fund, and the aggregate remaining fund information of the **Department of Labor and Human Resources (the Department)** as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the **Department's** financial statements, and have issued our modified report thereon dated June 28, 2018. In our report on the **Department's** financial statements our opinions for the Enterprise Funds and Business-Type Activities were qualified, because of inadequacies in the **Department's** accounting records and reconciliation procedures for recording financial transactions in the cash. Also, in our report on the **Department's** financial statements our opinions for the Governmental Activities and Governmental Funds were qualified, because of inadequacies in the **Department's** accounting records and reconciliation procedures for recording financial transactions in the accounts payable areas and that management has not recorded certain general capital assets in the governmental activities and, accordingly, has not recorded depreciation expense on those assets. In addition, the Department has not implemented the provisions and requirements of GASB 68 *"Accounting and Financial Reporting for Pensions"*.

Our report includes a reference to other auditors who audited the financial statements of the Vocational Rehabilitation Administration, which is an organizational component of the **Department** as described in our report on the **Department's** financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting and on compliance and other matters of the previously mentioned organizational components that are reported on separately by those auditors.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the **Department's** internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the **Department's** internal control. Accordingly, we do not express an opinion on the effectiveness of the **Department's** internal control. Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

INDEPENDENT AUDITORS' 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 (CONTINUED)

Internal Control over Financial Reporting (Continued)

However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies. 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items **2017-001, 2017-002, 2017-005, 2017-006 and 2017-007** to be *material weaknesses*. 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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items **2017-003** and **2017-004** to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the **Department's** financial statements are free from 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 the financial statements 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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Questioned Costs as items **2017-001, 2017-003, 2017-004, 2017-005, 2017-006** and **2017-007**.

Department's Response to Findings

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

INDEPENDENT AUDITORS' 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 (CONTINUED)

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 entity's internal control or on compliance. This report is an integral part of an audit performed 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.

López-Vega, CPA, PSC

LOPEZ-VEGA, CPA, PSC
San Juan, Puerto Rico
June 28, 2018
Stamp No. 2742181 of the Puerto Rico
Society of Certified Public Accountants
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López-Vega, CPA, PSC
Certified Public Accountants / Management Advisors

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE

To the Honorable Secretary and Management of the
Commonwealth of Puerto Rico
Department of Labor and Human Resources
San Juan, Puerto Rico

Report on Compliance for Each Major Federal Program

We have audited the **Department of Labor and Human Resources (the Department)'s** compliance with the types of compliance requirements described in the OMB Compliance Supplement that could have direct and material effect on each of the **Department's** major federal programs for the year ended June 30, 2017. The **Department's** major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

The **Department's** basic financial statements include the operations of the Vocational Rehabilitation Administration, which is an organizational component of the **Department**, and spent approximately **$45,870,000** in federal awards, which are not included in the Schedule of Expenditures of Federal Awards for the year ended June 30, 2017. Our audit, described below, did not include the operations of the Vocational Rehabilitation Administration because this organizational component engaged other auditors to perform an audit in accordance with OMB Compliance Supplement.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the **Department's** major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations Part 200, Uniform Administrative requirements, Cost Principle, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the **Department's** compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the **Department's** compliance.

Calle Paraná #1686, El Cerezal, San Juan, P.R. 00926-3144 – Tel. (787) 777-8044 / Fax (787) 764-9377

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE (CONTINUED)

Opinion on Each Major Federal Programs

In our opinion, the **Department** complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its other major federal programs identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs for the year ended June 30, 2017.

Other Matters

The results of our auditing procedures disclosed other instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying Schedule of Findings and Questioned Costs as items **2017-007** through **2017-009**. Our opinion on each major federal program is not modified with respect to these matters.

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

Report on Internal Control over Compliance

Management of the **Department** is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the **Department's** internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the **Department's** internal control over compliance.

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

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.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY THE UNIFORM GUIDANCE (CONTINUED)

Report on Internal Control over Compliance (Continued)

A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as item **2017-007** to be a material weakness.

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. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items **2017-008** and **2017-009** to be significant deficiencies.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

López-Vega, CPA, PSC

LOPEZ-VEGA, CPA, PSC

San Juan, Puerto Rico
June 28, 2018
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Section I – Summary of Auditors' Results

Financial Statements

Opinion Unit	**Type of Opinion**
Governmental Activities	Qualified
Business-type Activities	Qualified
General Fund	Qualified
Work Opportunity Incentive Fund	Qualified
Vocational Rehabilitation Administration Fund	Qualified GWFS Unmodified FFS
Special Revenue Fund	Qualified
Unemployment Insurance Fund	Unmodified
Disability Insurance Fund	Qualified
Drivers' Insurance Fund	Qualified
Aggregate Remaining Fund Information	Qualified

Internal control over financial reporting:		
Material weakness (es) identified?	☒Yes	☐No
Significant deficiency (ies)?	☒Yes	☐None Reported
Noncompliance material to financial statements noted?	☒Yes	☐No

Federal awards

Internal Control over major programs:		
Material weakness (es) identified?	☒Yes	☐No
Significant deficiency (ies)?	☒Yes	☐No
Type of auditor's report issued on compliance for major programs:	Unmodified	
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200 section 200.516(a) of the Uniform Guidance?	☒Yes	☐No

Identification of major programs:

CFDA Number	Name of Federal Program or Cluster
17.225	Unemployment Insurance
	Employment Service Cluster:
17.207	Employment Service, Wagner-Peyser Funded Activities
17.801	Disabled Veterans' Outreach Program (DVOP)
17.804	Local Veterans' Employment Representative Program (LVER)

Dollar threshold used to distinguish between Type A and Type B programs	**$3,000,000**	
Auditee qualified as low-risk auditee?	☐Yes	☒No

Section II – Financial Statements Findings

Finding No. 2017-001

Requirement: **Accounting System**

Type of Finding: **Material Weakness in Internal Control (MW).**
Instance of Noncompliance (NC).

This finding is similar to prior-year finding **2016-001.**

Statement of Condition

During the audit of the Department's basic financial statements for the fiscal year ended June 30, 2017, we noted the following deficiencies in the accounting system:

1. The accounting records are primarily designed for the recording of revenues, expenditures, and other limited transactions on a cash basis and not to provide the necessary information needed for the preparation of financial statements in accordance with generally accepted accounting principles. The conversion of the financial information of the accounting system obtained from a modified-accrual to a full accrual basis requires a significant effort by the **Department** and the recording of several adjusting entries in order to account for unrecorded transactions such as the accrual of receivables, accounts payable, unearned revenues, benefits payable, compensated absences, capital assets transactions, or to correct transactions accounted for in the incorrect accounting period.

2. As established in the Reorganization Plan Number 4 of December 9, 2011, the operations, employees, assets and functions of the Future Entrepreneurs and Worker's Training Administration were transferred to the Department effective January 8, 2012. During 2013, the beginning balances and the transactions related to the operations of FEWTA were recorded in the **Department's** accounting records, but the balances related with certain capital assets could not be estimated in order to be recorded. These capital assets were excluded from the 2017 financial statements.

3. No adequate and timely recording procedures are performed in the general ledger accounts.

4. Interfund transactions are not properly recorded and reconciled in the accounting records during the year. They required material adjustments at year-end.

5. The financial information is not reviewed, analyzed and reconciled on a monthly basis by management.

Section II – Financial Statements Findings (Continued)

Finding No. 2017-001 (Continued)

6. Certain differences were identified between the general ledger and the subsidiaries or details provided by management in the accounts payable area.

7. During our cut-off substantive and analytical procedures related to revenues and expenses, we noted that certain transactions were not recorded in the proper accounting period.

8. The **Department** has inadequate and/or incomplete budgeting control over financial transactions charged to federal grant awards. During our audit procedures, we noted that the costs charged to several grants during the grant period exceeded the amount approved in the award.

9. The **Department** does not have an accounting manual to be followed on significant areas such as collections, disbursements, accounts receivable, accounts payable, capital assets, purchases, and monthly and annual closings of books.

   Please refer to findings **2017-002, 2017-003, 2017-004** and **2017-005** for deficiencies in cash, accounts receivable, capital assets and accounts payable, respectively.

Criteria

20 CFR 200.510 requires auditees to prepare financial statements that reflect its financial position, results of operations and changes in net assets for the fiscal year audited. Also, the accounting system established should be designed to reflect or provide complete and clear information related to the agency's financial results of operations. It should also provide accurate reports that act as a basis for the preparation and support of the budget needs and for the control and proper monitoring of the budget.

29 CFR, Part 97, Subpart C, Section 97.20 "*Standards for financial management systems*", establishes the following: (a) A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its sub-grantees and cost-type contractors, must be sufficient to (1) Permit preparation of reports required by this part and the statutes authorizing the grant, and (2) Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes; (b) The financial management systems of other grantees and sub-grantees must meet the following standards: (1) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of financially assisted activities must be made in accordance with the financial reporting requirements of the grant or sub-grant; (2) *Accounting records.* Grantees and sub-grantees must maintain records which adequately identify the source and application of funds provided for financially-assisted activities. These records must contain information pertaining to grant or sub-grant awards and authorizations, obligations, unobligated balances, assets, liabilities, outlays or expenditures, and income;

Section II – Financial Statements Findings (Continued)

Finding No. 2017-001 (Continued)

(3) *Internal control*. Effective control and accountability must be maintained for all grant and sub-grant cash, real and personal property, and other assets. Grantees and sub-grantees must adequately safeguard all such property and must assure that it is used solely for authorized purposes; (4) *Budget control*. Actual expenditures or outlays must be compared with budgeted amounts for each grant or sub-grant. Financial information must be related to performance or productivity data, including the development of unit cost information whenever appropriate or specifically required in the grant or sub-grant agreement. If unit cost data is required, estimates based on available documentation will be accepted whenever possible; (5) *Allowable cost*. Applicable OMB cost principles, agency program regulations, and the terms of grant and sub-grant agreements will be followed in determining the reasonableness, allowability, and allocability of costs; (6) *Source documentation*. Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and sub-grant award documents, etc. (c) An awarding agency may review the adequacy of the financial management system of any applicant for financial assistance as part of a pre-award review or at any time subsequent to the award.

Act Number 230 of July 23, 1974, the *Puerto Rico Government Accounting Law*, as amended, states that the accounting system of the instrumentalities of the Commonwealth of Puerto Rico should be designed to reflect or provide complete and clear information related to their financial results of operations.

Cause of Condition

Lack of adequate accounting procedures for reconciliation and analysis of the financial transactions recorded during the year; lack of supervision of the Department of Finance's personnel; lack of GAAP governmental accounting knowledge of the personnel in charge of the **Department's** accounting and lack of proper training to them.

Effect of Condition

Not preparing and submitting monthly reconciled financial statements to management does not allow them to perform the following procedures:

1. Detection of any irregularities or instances of fraud on a timely basis,

2. Preparation of timely comparison between actual expenditures and budget,

3. Discussion of reports with the corresponding personnel and explanations of significant variations from budget,

4. Preparation of reports related to state and federal funding may be misleading for internal management decision making and for the reliability of external financial reporting, and

Section II – Financial Statements Findings (Continued)

Finding No. 2017-001 (Continued)

5. Compliance with corresponding financial reporting required by state and federal regulations.

Recommendations

The **Department** should evaluate the policies and procedures used by the Department of Finance in order to determine the changes needed to improve all the deficiencies mentioned in this report. Among the things to be considered in preparing a corrective action plan are the following:

1. Restructuring of the accounting recording process in order to obtain the information needed to prepare the financial statements in accordance with GAAP.

2. Provide and/or increase trainings to accounting personnel related to accounting functions and generally accepted accounting principles of governmental entities.

3. Increase supervision over the tasks performed by the accounting personnel.

4. Develop an accounting manual. Written procedures, instructions, and the assignment of duties will prevent or reduce misunderstandings, errors, inefficient or wasted efforts, duplicated or omitted procedures, and other situations that could result in inaccurate or untimely accounting records.

5. Management must ensure that interfund transactions are properly and timely recorded. Also, reconciliation is required to ensure that all funds reflect their corresponding transactions.

6. Incorporate into the **Department's** accounting system the financial transactions of FEWTA related to capital assets.

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section II – Financial Statements Findings (Continued)

Finding Reference 2017-002

Requirement: **Cash Accounts and Reconciliation Procedures**

Type of Finding: **Material Weakness in Internal Control (MW).**
Instance of Noncompliance (NC).

This finding is similar to prior-year finding **2016-002.**

Statement of Condition

During our audit procedures in the cash area, we noted the following deficiencies:

1. Balances of the bank accounts held by the Treasury Department of the Commonwealth of Puerto Rico in the governmental funds were not reconciled with the PRIFAS system. There are no established procedures for the reconciliation of these accounts.

2. The **Department** maintains the responsibility over the preparation of several bank reconciliations of the General Fund, Work Opportunity Incentive Fund, and Other Governmental Funds. After our examination of the bank reconciliations prepared by the accounting personnel of the **Department**, we noted that the accounting records and the general ledger had unreconciled differences in the cash accounts when compared with the bank reconciliations as follows:

Bank Account No.	Accounts Name	Difference
367-1002-8	Special Disbursement Officer	$ (12,996,512)
256-0006-8	Cash FOT PRIFAS	63,349,955
256-0005-9	Administration of the Bureau of Employment Security	(19,161,960)
256-0003-2/030-050286	Fondo Auxiliar Especial	(1,009,696)

3. The following bank reconciliations as of June 30, 2017 included reconciling items over fourteen years old:

   a. Account Number 367-1002-8 - Special Disbursement Officer
   b. Account Number 367-1701-2- Special Disbursement Officer-Payroll

Section II – Financial Statements Findings (Continued)

Finding Reference 2017-002 (Continued)

4. The bank account reconciliation process followed by the **Department's** personnel does not include the reconciliation of the cash balance per bank with the balance of the general ledger account.

Criteria

Regulation Number 9, Regulation of Basic Rules for the Special Disbursement Officers appointed by the Secretary of the Treasury, Article XI (Bank Reconciliations) states the following:

1. If there are differences between the information provided by the bank and the records of the Special Disbursement Officer, they shall be clarified before submitting the reconciliation for the approval of the Head of the Agency or the Authorized Representative. The Head of the Agency or his Authorized Representative should be informed if the above situation occurs.

2. The agencies will be responsible for immediately solving any difference arising in the bank reconciliation. Under no circumstances should any difference arising in that reconciliation remain unresolved for a period longer than 10 days. If the difference is not resolved during that period, the Treasury Department should not approve any funding request until the difference is clarified.

3. After the reconciliation is made, the person in charge of preparing it should certify it as correct and seek the approval of the Head of the Agency or the Authorized Representative.

4. The Special Disbursement Officer's reconciliation must be prepared within three days after receipt of the bank statement or, if more time is needed, an extension of five more days could be provided by the Head of the Agency.

Circular Letter No. 1300-47-08, "Instructions for the Special Disbursement Officers related to Deposits in Transit and Outstanding Checks in the bank reconciliation," states that:

1. Deposits in Transit - The person responsible for preparing the reconciliation of bank accounts shall segregate and total the deposits by fund number. Under no circumstances, requests for funds that are disbursed by electronic transfer must be considered as deposits in transit.

2. Outstanding Checks – The person responsible for preparing the bank reconciliations shall segregate and aggregate them by fund number. In cases where a check affects two funds the amount of each fund should be detailed.

Section II – Financial Statements Findings (Continued)

Finding Reference 2017-002 (Continued)

Regulation Number 19, Cancelled Checks, Article 4 (Cancellation of Checks with More than Six Months Issued), states that checks for state and federal funds issued through RHUM, PRIFAS or PRITAS system that meet six months of issuance and outstanding will be cancelled automatically and the amount thereof credited to their account of origin.

Cause of Condition

Lack of adequate procedures and supervision of the tasks performed by the accounting personnel in charge of preparing the bank reconciliations. Also, the **Department** needs the authorization of the **Department** of the Treasury for cleaning-up old reconciling items in order to adjust the balance of the general ledger of cash accounts under the Department of the Treasury's custody. The **Department** is waiting for such authorization.

Effect of Condition

Deficiencies previously mentioned do not permit adequate control over cash receipts and disbursements, the timely detection of irregularities and the proper reporting of the cash balance in the basic financial statements.

Recommendation

We recommend management the following:

1. Establish procedures for the preparation of monthly reconciliations of the accounting transactions of all cash accounts held by the Commonwealth of Puerto Rico Treasury Department. Implementation of this policy would allow management to take appropriate action on a timely basis to correct discrepancies that might arise due to bookkeeping errors, bank errors or misappropriation or misuse of funds as well as to provide an independent verification of the receipts and disbursements functions.

2. Differences in the bank reconciliation should be resolved in a reasonable period and all necessary adjustments should be posted to the general ledger account.

3. All bank accounts should be reconciled immediately upon receipt of the bank statement and should be reviewed by a responsible official. This review should be evidenced by the reviewer's initials and include the following procedures:

    a. The balance per bank shown in the reconciliation agrees with the bank statement.

Section II – Financial Statements Findings (Continued)

Finding Reference 2017-002 (Continued)

b. The reconciled balance agrees with the general ledger.
c. Review the reconciliation for unusual items.
d. The details of deposits in transit and outstanding checks are included in the bank reconciliation.
e. Outstanding checks for more than six months of issuance should be adjusted in the bank reconciliation.
f. Compare the reconciliation to the prior period for items outstanding not cleared during the current period.

4. Management should consider the consolidation of cash accounts whenever possible. With fewer bank accounts, a tighter control over cash accounts can be achieved which would reduce the risk of misappropriated funds and resources needed to prepare the reconciliations.

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section II – Financial Statements Findings (Continued)

Finding No. 2017-003

Requirement: **Financial Reporting: Subsidiaries of Accounts Receivable – Proprietary Funds**

Type of Finding: **Significant Deficiency in Internal Control (SD).**
Instance of Noncompliance (NC).

This finding is similar to prior-year finding **2016-003.**

Statement of Condition

During our audit procedures over accounts receivable area, we noted the following deficiencies:

1. The aging of accounts receivable is not maintained for the following accounts:

   a. Accounts Receivable - Others (Unemployment Insurance Fund)
   b. Insurance Premiums (Drivers' Insurance Fund)

   A detail of the accounts mentioned above was provided in the Excel format instead of an aging of accounts receivable.

2. The Accounts Receivable Aging of Insurance Premiums from Drivers Insurance, Disability Insurance and Unemployment Insurance is not accurate. It has old balances and the **Department** uses as an alternative procedure a detail of subsequent collections to establish the balance of the accounts receivable.

3. The **Department** does not have an adequate methodology to record, review, and adjust the provision for bad debts.

Criteria

The Accounting Manual for the Drivers' Insurance Fund, Section 2.4.1, General Ledger Accounts, states that insurance premiums receivable should be detailed in an Accounts Receivable Subsidiary Ledger.

20 CFR 200.510, requires auditees to prepare financial statements that reflect its financial position, results of operations or changes in net position for the fiscal year audited. Also, the accounting system established should be designed to reflect or provide complete and clear information related to the agency's financial results of operations. It should also provide accurate reports that act as a basis for the preparation and support of the budget needs and for the control and proper monitoring of this budget.

Moreover, Act Number 230 of July 23, 1974 - *Puerto Rico Government Accounting Law*, as amended, stipulates that the accounting system established should be designed to reflect or provide complete and clear information related to the agency's financial results of operations.

Section II – Financial Statements Findings (Continued)

Finding Reference 2017-003 (Continued)

Cause of Condition

The **Department** does not maintain the accounts receivable subsidiary ledger due to the inadequacy of its records. Also, there is a lack of analysis by management of the existing reports.

Effect of Condition

The **Department** has not been able to implement proper collection efforts of past due accounts and thus, the **Department's** accounting system does not properly present the financial results of the operations. Failure to perform a periodic analysis of amounts due to the **Department** and to develop a consistent methodology to support the amounts recorded as uncollectible accounts receivable could result in a material misstatement of accounts receivable balance.

Recommendation

We recommend management the following:

1. A formal accounts receivable subsidiary aging should be established for those funds that do not have one.

2. Management should review periodically the insurance premiums receivable subsidiaries of the Disability Insurance and Unemployment Funds and eliminate old and uncollectible receivable balances.

3. The **Department** should implement controls to periodically review the accounts receivable and adopt a methodology to record, review, and adjust the provision for bad debts based upon historical collectability data.

4. Improve collection efforts.

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section II – Financial Statements Findings (Continued)

Finding No. 2017-004

Requirement: **Financial Reporting: Capital Assets**

Type of Finding: **Significant Deficiency in Internal Control (SD).**
Instance of Noncompliance (NC).

This finding is similar to prior-year finding **2016-004.**

Statement of Condition

During our audit procedures over the capital assets area, we noted the following deficiencies:

1. The accounting system of the **Department** provides for the use of a capital assets module. This tool is not used to record capital assets, related depreciation and identifying information.

2. The **Department** did not provide us evidence of the physical inventory properly reconciled with the property ledgers as required by federal and state regulations.

3. Certain capital assets of the FEWTA were excluded from the financial statements.

Criteria

Act Number 230 of July 23, 1974, *Puerto Rico Government Accounting Law,* as amended, states that the accounting system of the instrumentalities of the Commonwealth of Puerto Rico should be designed to reflect or provide complete and clear information related to their financial results of operations.

Regulation No. 11, Basic Standards for Control and Accounting for Fixed Assets, Section XIV (A) and (G) – Physical Inventory, establishes that the internal records of inventory must be supported by physical inventories; and the physical inventory should be checked against the internal records of the agency. In addition, Section XVI – General Dispositions, states that agencies must keep its own internal procedures for the control of fixed assets so that the property manager is aware of the acquisition and disposition thereof.

Cause of Condition

There are no adequate accounting policies and procedures for the reconciliation and analysis of the accounting transactions, specifically related to capital assets recording, retirement, depreciation and physical safeguarding.

Section II – Financial Statements Findings (Continued)

Finding No. 2017-004 (Continued)

Effect of Condition

The **Department** is not in compliance with state and federal regulations. Also, failure to maintain an adequate property subsidiary might cause errors and misuse of the equipment purchased with federal funds that may result in questioned costs.

Recommendation

We recommend the **Department** to improve its internal control and procedures as follows:

1. Maintain accurate and complete property records that include a description of the property, a property ID number, source of property, acquisition date, original cost, federal share of the cost, property location and disposal data.

2. Results of physical inventory should be properly reconciles with the property records.

3. Adequate monitoring procedures must be implemented to improve efficiency of the operations.

4. The **Department** must ensure compliance with state and federal regulations related to capital assets.

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section II – Financial Statements Findings (Continued)

Finding No. 2017-005

Requirement: **Financial Reporting: Accounts Payable, Unearned Revenues, Benefits Payable, And Encumbrances**

Type of Finding: **Material Weakness in Internal Control (MW).**
Instance of Noncompliance (NC).

This finding is similar to prior-year finding **2017-005.**

Statement of Condition

During our audit procedures over the accounts payable area, we noted the following:

Accounts Payable – Governmental Funds

1. The subsidiaries of accounts payable are not reconciled with the general ledger and are not being reviewed periodically. Most of the funds accounts payable balances in the general ledger had the same balances of the prior year.
2. The **Department** does not maintain a reconciled subsidiary breakdown of the accounts recorded in accounts L5030, L5010, – Vouchers Payable, L5250 and L5251 – Accounts Payable to Public Corporation and 5250- Advances Other Funds Payable as of June 30, 2017.

Unearned Revenues – Proprietary Funds

1. During our audit procedures, we observed that the Credit Employers Report from the Unemployment Insurance fund included credits collections for periods that could not be determined and also includes inactive employers. Therefore, the balance of this account was overstated. The **Department's** management made an analysis of the account and proposed an adjustment to correct the account balance.

Benefits Payable – Proprietary Funds

1. The subsidiaries of benefits payable are not maintained for the Drivers' Insurance and Disability Insurance Funds. The **Department** has established procedures to determine balances of benefits payable at the end of the year for financial presentations based on existing claims.

Encumbrances – Governmental Funds

1. The subsidiaries of encumbrances are not reconciled with the general ledger accounts.

Section II – Financial Statements Findings (Continued)

Finding No. 2017-005 (Continued)

Criteria

20 CFR 200.510 require auditees to prepare financial statements that reflect its financial position, results of operations or changes in net position for the fiscal year audited. Also, the accounting system established should be designed to reflect of provide complete and clear information related to the agency's financial results of operations. It also provides accurate reports that act as a basis for the preparation and support of the budget needs and for the control and proper monitoring of this budget.

Act Number 230 of July 23, 1974, *Puerto Rico Government Accounting Law,* as amended, states that the accounting system of the instrumentalities of the Commonwealth of Puerto Rico should be designed to reflect or provide complete and clear information related to their financial results of operations.

Cause of Condition

Lack of analysis by the **Department's** management and adequate procedures for reviewing and adjusting the subsidiaries at end of the month.

Effect of Condition

We were unable to determine proper recording and balances of liabilities since there were no reliable accounts payable subsidiary ledgers.

Recommendation

We recommend the following:

1. The Finance Department should maintain a subsidiary of all open invoices that must be reconciled on a monthly basis with the general ledger's account balance. Differences and reconciling items should be investigated and adjusted on a timely basis. Management should review periodically the reports for accuracy and completeness.

2. The internal control structure over benefits payable should be reviewed in order to provide assurance of the appropriate reconciliation and recording of these obligations

3. The subsidiaries of encumbrances should be reconciled with the general ledger's accounts and on a monthly basis.

Section II – Financial Statements Findings (Continued)

Finding No. 2017-005 (Continued)

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section II – Financial Statements Findings (Continued)

Finding No. 2017-006

Requirement:	**Recognition and Reporting of Net Pension Liability – Cost Sharing Pension Plans**
Type of Finding:	**Material Weakness in Internal Control (MW).** **Instance of Noncompliance (NC).**

This finding is similar to prior-year finding **2016-006.**

Statement of Condition

Management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68, *"Accounting and Financial Reporting for Pensions"*. The amount by which this departure would affect the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the **Department's** governmental activities has not been determined.

In addition, the **Department's** financial statements do not disclose the descriptive information about the pension plans through which the pensions are provided required by the GASB Statement No. 68 for cost-sharing employers. Also, management has omitted historical pension information that accounting principles generally accepted in the United States of America required to be presented to supplement the basic financial statements.

Criteria

GASB Statement No. 68 states the accounting and financial reporting requirements for pension plans provided to employees of state and local governments that are administered through cost-sharing pension plan trusts that comply with the criteria set forth in the Statement. This requires that the **Department** report in its financial statements its proportionate share of the collective net pension liability, pension expense and deferred outflows and inflows of resources related to pensions as of the measurement date. It also requires detailed disclosures related to the actuarial and financial information used in the calculation of the net pension liability and the reporting of historical pension data as Required Supplementary Information.

Cause of Condition

The pension plan administrator of the **Department's** pension plan has not provided the audited actuarial and financial information necessary for the proper recognition and reporting of its net pension liability and the required supplementary information as of June 30, 2017.

Section II – Financial Statements Findings

Finding No. 2017-006 (Continued)

Effect of Condition

The **Department** has not been able to properly implement the GASB Statement No. 68 and comply with its requirements.

Recommendation

We recommend the **Department** to maintain a constant communication with the pension plan's administrator, the Commonwealth's Employees Retirement System Administration, in order to obtain the necessary audited actuarial and financial information necessary to comply with the requirements of the GASB Statement No. 68.

Questioned Cost

None

Auditee Response

See Grantee's Corrective Action Plan

Section III - Major Federal Award Program Findings and Questioned Costs

Finding No. 2017-007

Federal Agency:	**United States Department of Labor**
Federal Program Title and CFDA Number:	**All Federal Programs**
Compliance Requirement:	**Financial Reporting**
Type of Finding:	**Material Weakness in Internal Control (MW).** **Instance of Noncompliance (NC).**

This finding is similar to prior-year finding **2016-007.**

Statement of Condition

As discussed in Findings **2017-001, 2017-002, 2017-004**, and **2017-005**, the **Department** has several deficiencies regarding internal control structure over financial reporting. Due to such failure, the **Department** does not have the ability to produce accurate federal reports on a timely basis and federal programs were not properly monitored as to compliance with applicable laws and regulations. Refer to those findings for more detail.

Criteria

Refer to findings **2017-001, 2017-002, 2017-4** and **2017-005**

Cause of Condition

Refer to findings **2017-001, 2017-002, 2017-4** and **2017-005**

Effect of Condition

Refer to findings **2017-001, 2017-002, 2017-004** and **2017-005**

Recommendation

Refer to findings **2017-001, 2017-002, 2017-004** and **2017-005**

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section III - Major Federal Award Program Findings and Questioned Costs

Finding No. 2017-008

Federal Agency:	**United States Department of Labor**
Federal Program Title and CFDA Number:	**17.225 Unemployment Insurance**
Compliance Requirement:	**Reporting**
Type of Finding:	**Significant Deficiency in Internal Control (SD).** **Instance of Noncompliance (NC).**

This finding is similar to prior-year finding **2016-008.**

Statement of Condition

During the procedures performed over the financial and performance reporting requirements, we noted the following instances of noncompliance:

- Reports ETA 581 Contributions Operation for the period ending in September 30, 2016 was submitted to the Employment and Training Administration Offices with 12 days of delay.
- The report ETA 191 for the period ending in December 31, 2016 was submitted with 2 days of delay.

In addition, as part of our evaluation of internal control procedures, we noted that the reports ETA 581 and ETA 2112 reports are prepared and submitted to the Federal government by the same employee. Such reports are not reviewed by an independent employee.

Criteria

Based on 2 CFR 200.327 and 200 CFR 200.328, monitoring activities for reporting compliance requirements should include the review by external parties to corroborate information included in the reports of Federal awards or periodic comparison of reports to supporting records.

Cause of Condition

There no procedures in place to segregate duties of preparing and reviewing federal reports before submitted them to Federal government.

Effect of Condition

Reports submitted to the Federal government may contain errors and not be detected on time.

Section III - Major Federal Award Program Findings and Questioned Costs (Continued)

Finding No. 2017-008 (Continued)

Recommendation

Procedures should be implemented to establish a review of the federal reports by an employee independent of preparing them before their submission to the Federal government.

Questioned Costs

None

Auditee Response

See Grantee's Corrective Action Plan

Section III - Major Federal Award Program Findings and Questioned Costs (Continued)

Finding No. 2017-009

Federal Agency:	**United States Department of Labor**
Federal Program Title and CFDA Number:	**17.225 Unemployment Insurance**
Compliance Requirement:	**Cash Management**
Type of Finding:	**Significant Deficiency in Internal Control (SD).** **Instance of Noncompliance (NC).**

This finding is similar to prior-year finding **2016-009.**

Statement of Condition

Federal funds for unemployment benefits payments are requested by a specific employee. That employee determines the amount to be requested and performs the request. No review or approval is performed by another independent person during the period from July 1, 2016 to February 1, 2017. Effective on February 1, 2017, the **Department** has temporarily assigned an employee to supervise this area.

Criteria

Based on **2 CFR PART 200**, Part 6, Internal Control, monitoring activities for cash management. Such reviews should be based on cash management, budget and actual results and Federal drawdown activities.

Cause of Condition

There is no procedure in place to segregate the duties of determining the amount of federal funds to be requested based on benefits payments disbursed from the review of such determination and the request of funds.

Effect of Condition

Amounts of funds requested may not be in accordance with unemployment benefits paid. It also has the risk that state benefits be requested from federal funds and not be timely detected.

Recommendation

Procedures should be implemented to designate an independent employee to perform a review of the amount of federal funds determined to be requested and all supporting documentation before placing the request to the Federal government.

Questioned Cost

None

Section III - Major Federal Award Program Findings and Questioned Costs (Continued)

Auditee Response

See Grantee's Corrective Action Plan

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-001 Accounting System	We concur with the finding.	1. In connection with the fiscal and economic emergency status the Commonwealth of Puerto Rico is undergoing, the Working Group for the Fiscal and Economic Recovery of Puerto Rico (the "Working Group") established by previous Governor, Alejandro García Padilla (Executive Order (EO 2015-022) set up a Fiscal and Economic Growth Plan (FEGP) where the Working Group and its advisors examined the various causes of the challenges facing the Commonwealth, and have recommended potential reform measures to address those challenges. Among the challenges addressed, the FEGP acknowledged that (1) the central government's financial and payroll systems are obsolete and cannot communicate with the systems of principal agencies, such as the **Department**, and (2) that the lack of integration of agencies under the same platform hinders the ability to timely monitor expenses, complete annual audits and publish accounting financial statements. As part of the FEGP, the Commonwealth is planning to implement a new financial/accounting and payroll system that unifies the patchwork of governmental platforms, which affect the government and its agencies' ability to properly monitor its fiscal situation and result in material delays in the preparation of financial information. Based on the suggestion by the FEGP, the new accounting system is expected to be installed during the fiscal year 2018-2019. Nevertheless, on June 30th, 2016, President Barack Obama signed into law the Puerto Rico Oversight, Management and Economic Stability Act (PROMESA) to create an oversight of the Island's budget and fiscal policies for the next few years. Subject of future approval, before it may come into effect.

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-001 Accounting System		2. On December 18, 2017, Act No. 122 known as the Puerto Rico New Government Act was enacted. This Act allows the Governor of Puerto Rico to maximize the resources and personnel of the Executive Branch through the transfer, consolidation, reorganization, outsourcing and creation of new and more efficient governmental structures and agencies. Based on this Act, the Reorganization Plan Number 2 of January 18, 2018 was established. This Plan will create the Labor Relations Bureau within the **Department**, to handle and consolidate in one place all litigations previously handled by the Public Service Appellate Commission, the Labor Relations Commission and the Investigation, Prosecution and Appeals Commission. In addition, the **Department** will transfer all its educational programs to the Puerto Rico Department of Education, including all the FEWTA buildings. For points 3 to 9, please refer to answer 1. Implementation Date: July 2019 Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-002 Cash Accounts and Reconciliation Procedures	We concur with the finding.	1. Please refer to answer 1 for finding 2017-001. 2. The **Department** has assigned a team of employees to work on identifying the established differences. Up to date, they are working on account reconciliations. 3. Since the **Department** needs an express authorization from the PR Treasury Department to adjust reconciling items when over six years old, the **Department** has been in contact with the PR Treasury Department to establish a work plan to adjust accounting records. Currently, PRDOL started a process with the Treasury Department to eliminate pending transactions for the periods from 1995 to 2010. 4. The **Department** continues with the reconciliations of cash balances per bank with the balances in the general ledger. More specifically, for the UI benefit account from July 2012 they are now and has finished it up to January 2018. Implementation Date: July 2019 Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director

Francisco Torres, Auxiliary Secretary of Management Affairs

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-003 Financial Reporting: Subsidiaries of Accounts Receivable – Proprietary Funds	We concur with the point 2 and do not concur with the point 1 and 3 of the finding.	1. The **Department** does not agree with the auditor's finding. Even though an aging from the system could not be provided, a detail in Excel format was provided. No exceptions for this was mentioned. Please also refer to answer 1. in finding 2017-001. 2. Please refer to answer 1. for finding 2017-001. 3. The methodology used by the **Department** is one determined by management and used as an estimate to calculate the provision of bad debts. The **Department** understands that the methodology used is conservative and practical. Implementation Date: July 2019 Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director; Mr. José A. Ríos, Disability Program Director; Mr. Luis Costas, Drivers' Program Director

Francisco Torres, Auxiliary Secretary of Management Affairs

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO | **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES | **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 | Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs   Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-004 Financial Reporting: Capital Assets	We concur with the finding.	1. The capital asset module is managed by the Puerto Rico Department of Treasury, and the Department is not authorized to access this area of the system. The **Department** does have a capital assets detail in Excel format used to record the assets details. For financial reporting purposes the calculation of depreciation is also performed and recorded. No exceptions were mentioned on this procedure. 2. The **Department** performs annual inventories and submits required data to the PR Department of Treasury for the consolidation of data, as all other government agencies do. 3. Please refer to answer 2. for finding 2017-001. Implementation Date: July 2019 Responsible Persons: Mr. Francisco Torres, Auxiliary Secretary; Ms. Enid Iglesias, Acting Administrative Services Director; Ms. Yesenia Rivera, Finance Director

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO | **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES | **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-005 Financial Reporting: Accounts Payable, Unearned Revenues, Benefits Payable, And Encumbrances	We concur with the finding.	For Accounts Payable points 1 and 2, please refer to answer 1. for finding 2017-001. Unearned Revenues - The **Department** worked with the Information Technology Area to produce customized reports that would help the Finance Division resolve this matter. Benefits Payable - Please refer to answer 1. for finding 2017-001. Encumbrances - The **Department** has assigned personnel to work on this reconciliation. They have completed reconciliations up to fiscal year 2015. Implementation Date: July 2019 Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director Mr. José A. Ríos, Workers' Benefit Auxiliary Secretary; Mr. Luis Costas, Drivers' Insurance Director; Ms. Sandra Valentín, UI Program Director

Francisco Torres, Auxiliary Secretary of Management Affairs

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-006 Recognition and Reporting of Net Pension Liability – Cost Sharing Pension Plans	We concur with the finding.	As per Circular Letter #1300-23-16 issued by the Puerto Rico Treasury Department, the audited actuarial and financial information necessary to comply with the requirements of the GASB Statement No. 68 was going to be available for the second quarter of the Fiscal Year ended June 30, 2017. As of today, no such report has been issued. Once the audited financial information for the **Departmen**t is available, the **Department** will be able to properly implement GASB Statement No. 68 in its Government-Wide Financial Statements. Implementation Date: To be determined, not under the control of the **Department**. Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

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Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-007 Financial Reporting	We concur with the finding.	This is a repeated finding. Refer to findings **2017-001**, **2017-002**, **2017-004** and **2017-005** for management's corrective action plan. Implementation Date: To be determined, not under the control of the **Department**. Implementation Date: July 2019 Responsible Individuals: Mr. Francisco Torres, Auxiliary Secretary; Ms. Yesenia Rivera, Finance Director Mr. José A. Ríos, Workers' Benefit Auxiliary Secretary; Mr. Luis Costas, Drivers' Insurance Director; Ms. Sandra Valentín, UI Program Director

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-008 Reporting	We concur with the finding.	1. The **Department's** management has discussed with the Tax Division Director of the division the importance of timely filing of ETA reports. PRDOL continues to work toward full compliance. Implementation Date: Throughout the 2018-2019 fiscal year. Responsible Individuals: Mr. Vladimir Miranda, Tax Division Director; Mr. José A. Rios, Workers' Benefit Auxiliary Secretary

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

COMMONWEALTH OF PUERTO RICO | **CORRECTIVE ACTION PLAN**

DEPARTMENT OF LABOR AND HUMAN RESOURCES | **FOR THE YEAR ENDED JUNE 30, 2017**

Phone: (787) 754-5353 | Fiscal Year: 2016-2017

Audit Report: Reports on Compliance and Internal Control in Accordance with Governmental Auditing Standards and OMB Super Circular Uniform Guidance

Audit Period: July 1, 2016 – June 30, 2017

Principal Executive: Francisco Torres, Auxiliary Secretary of Management Affairs | Contact Person: María del Carmen La Santa, Executive Assistant Federal Affairs

Original Finding Number	Statement of Concurrence or Non concurrence	Corrective Action
2017-009 Cash Management	We concur with the finding.	The **Department** has assigned an employee to this area, effective February 1, 2017. Implementation Date: Throughout the 2016-2017 fiscal year. Responsible Individuals: Mrs. Sandra Valentín, UI Program Director; Mrs. Wanda Fontanez, Human Resources Director

I CERTIFY THAT THE INFORMATION ABOVE IS CORRECT

Francisco Torres, Auxiliary Secretary of Management Affairs

JUNE 28, 2018

DEPARTMENT OF LABOR AND HUMAN RESOURCES
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017

FINDING NUMBER	FINDING OR CONDITION	CURRENT STATUS	REFER TO CURRENT YEAR FINDING
2016-001	***Accounting System***		
	During the audit of the **Department's** basic financial statements for the fiscal year ended June 30, 2016, we noted the following deficiencies in the accounting system:		
	1. The accounting records are primarily designed for the recording of revenues, expenditures, and other limited transactions on a cash basis and not to provide the necessary information needed for the preparation of financial statements in accordance with generally accepted accounting principles. The conversion of the financial information of the accounting system obtained from a modified accrual to a full accrual basis requires a significant effort by the **Department** and the recording of several adjusting entries in order to account for unrecorded transactions such as the accrual of receivables, accounts payable, unearned revenue, benefits payable, compensated absences, capital assets transactions, or to correct transactions accounted for in the incorrect accounting period.	In process	2017-001 (item 1)
	2. As established in the Reorganization Plan Number 4 of December 9, 2011, the operations, employees, assets and functions of the Future Entrepreneurs and Worker's Training Administration were transferred to the **Department** effective January 8, 2012. During 2013 the beginning balances and the transactions related to the operations of FEWTA were recorded in the **Department's** accounting records, but the balances related with certain capital assets could not be estimated in order to be recorded. These capital assets were excluded from the 2016 financial statements.	In process	2017-001 (item 2)
	3. No adequate and timely recording procedures are performed in the general ledger accounts.	In process	2017-001 (item 3)
	4. Interfund transactions are not properly recorded and reconciled in the accounting records during the year. They required material adjustments at year-end.	In process	2017-001 (item 4)
	5. The financial information is not reviewed, analyzed and reconciled on a monthly basis by management.	In process	2017-001 (item 5)
	6. Certain differences were identified between the general ledger and the subsidiaries or details provided by management in the accounts payable area.	In process	2017-001 (item 6)
	7. During our cut-off, substantive and analytical procedures related to revenues and expenses, we noted that certain transactions were not recorded in the proper accounting period.	In process	2017-001 (item 7)
	8. The **Department** has inadequate and/or incomplete budgeting control over financial transactions charged to federal grant awards. During our audit procedures, we noted that the costs charged to several grants during the grant period exceeded the amount approved in the award.	In process	2017-001 (item 8)
	9. The **Department** does not have an accounting manual to be followed on significant areas such as collections, disbursements, accounts receivable, accounts payable, capital assets, purchases, and monthly and annual closings of books.	In process	2017-001 (item 9)
	Please refer to findings **2016-002**, **2016-003**, **2016-004** and **2016-005** for deficiencies in cash, accounts receivable, capital assets and accounts payable, respectively.		

DEPARTMENT OF LABOR AND HUMAN RESOURCES
SCHEDULE OF STATUS OF PRIOR YEAR AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017

FINDING NUMBER	FINDING OR CONDITION	CURRENT STATUS	REFER TO CURRENT YEAR FINDING
2016-002	***Cash Accounts and Reconciliation Procedures*** During our audit procedures in the cash area, we found the following deficiencies:		
	1. Balances of the bank accounts held by the Treasury Department of the Commonwealth of Puerto Rico in the governmental funds were not reconciled with PRIFAS system. There are no established procedures for the reconciliation of these accounts.	In process	2017-002 (item 1)
	2. The **Department** maintains the responsibility over the preparation of several bank reconciliations of the General Fund, Work Opportunity Incentive Fund, and Special Revenue Funds. After our examination of bank reconciliations prepared by the accounting personnel of the **Department**, we noted that the accounting records and the general ledger had unreconciled differences in the cash accounts when compared with the bank reconciliations as follows: 367-1002-8 Special Disbursement Officer $ (12,996,588) 256-0006-8 Cash FOT PRIFAS $ 63,350,019 256-0005-9 Administration of the Bureau of Employment Security $ (19,152,863) 256-0003-2 Fonfo Auxiliar Especial $ 151,278	In process	2017-002 (item 2)
	3. The following bank reconciliations as of June 30, 2015 included reconciling items over fourteen years old: - Account Number 367-1002-8 - Special Disbursement Officer - Account Number 367-1701-2- Special Disbursement Officer-Payroll	In process	2017-002 (item 3)
	4. The supporting documentation for the following reconciling items was not provided for our examination: a. A detail of the composition of the item "balance on bank before August 30, 2012" in the amount of $60,308 for the Special Disbursement Officer Account (account no. 415-2006-9).	Corrected	N/A
	5. The bank account reconciliation process followed by the **Department's** personnel do not include the reconciliation of the cash balance per bank with the balance of the general ledger account.	In process	2017-002 (item 4)
2016-003	***Financial Reporting: Subsidiaries of Accounts Receivable – Proprietary Funds*** During our audit procedures over accounts receivable area we noted the following deficiencies:		
	1. The aging of accounts receivable is not maintained for the following accounts: a. Accounts Receivable - Others (Unemployment Insurance Fund) b. Insurance Premiums (Drivers' Insurance Fund) A detail was provided in the Excel format of the accounts mentioned above instead of an aging of accounts receivable.	In process	2017-003 (item 1)

FINDING NUMBER	FINDING OR CONDITION	CURRENT STATUS	REFER TO CURRENT YEAR FINDING
	2. The Accounts Receivable Aging of Insurance Premiums from Drivers Insurance, Disability Insurance and Unemployment Insurance is not accurate. It has old balances and the **Department** uses as an alternative procedure a detail of subsequent collections to establish the balance of the accounts receivable.	In process	2017-003 (item 2)
	3. The **Department** does not have an adequate methodology to record, review, and adjust the provision for bad debts.	In process	2017-003 (item 3)
2016-004	***Financial Reporting: Capital Assets*** During our audit procedures over the capital assets area we noted the following deficiencies:		
	1. The accounting system of the **Department** provides for the use of a capital assets module. This tool is not used to record capital assets, related depreciation and identifying information.	In process	2017-004 (item 1)
	2. The **Department** did not provide us evidence of the physical inventory properly reconciled with the property ledgers as required by federal and state regulations.	In process	2017-004 (item 2)
	3. Certain capital assets of the FEWTA were excluded from the financial statements.	In process	2017-004 (item 3)
2016-005	***Financial Reporting: Accounts Payable, Unearned Revenues, Benefits Payable, and Encumbrances*** During our audit procedures over the accounts payable area, we noted the following: <u>Accounts Payable – Governmental Funds:</u>		
	1. The subsidiaries of accounts payable are not reconciled with the general ledger and are not being reviewed periodically. Most of the funds accounts payable balances in the general ledger had the same balances of the prior year.	In process	2017-005 (item 1)
	2. The **Department** does not maintain a reconciled subsidiary breakdown of the accounts recorded in accounts L5030 – Vouchers Payable, L5250 and L5251 – Accounts Payable to Public Corporation and 5250 - Advances Other Funds Payable as of June 30, 2016.	In process	2017-005 (item 2)
	<u>Unearned Revenues – Proprietary Funds</u> During our audit procedures, we observed that the Credit Employers Report from the Unemployment Insurance fund included credits collections for periods that could not be determined. Therefore, the balance of this account was overstated. **Department's** management made an analysis of the account and proposed an adjustment to correct the account balance.	In process	2017-005 (item 1)

FINDING NUMBER	FINDING OR CONDITION	CURRENT STATUS	REFER TO CURRENT YEAR FINDING
	<u>Benefits Payable – Proprietary Funds</u> 1. The subsidiaries of benefits payable are not maintained for the Drivers Insurance and Disability Insurance Funds. The **Department** has established procedures to determine balances of benefits payable at the end of the year for financial presentations based on existing claims. <u>Encumbrances – Governmental Funds</u> Subsidiaries of encumbrances are not reconciled with the general ledger accounts.	In process In process	2017-005 (item 1) 2017-005 (item 1)
2016-006	**Recognition and Reporting of Net Pension Liability – Cost Sharing Pension Plans** Management has not complied with the accounting and financial reporting requirements for pensions that are provided to the employees of state and local governmental employers through pension plans trusts that comply with the criteria set forth in the GASB Statement No. 68, Accounting and Financial Reporting for Pensions. The amount by which this departure would affect the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position of the **Department's** governmental activities has not been determined. In addition, the **Department's** financial statements do not disclose the descriptive information about the pension plans through which the pensions are provided required by the GASB Statement No. 68 for cost-sharing employers. Also, management has omitted historical pension information that accounting principles generally accepted in the United States of America required to be presented to supplement the basic financial statements.	In process	2017-006
2016-007	***Financial Reporting – All Federal Programs Reportable Condition*** As discussed in Findings **2016-001**, **2016-002**, **2016-004**, and **2016-005**, The **Department** has several deficiencies regarding internal control structure over financial reporting. Due to such failure, the **Department** does not have the ability to produce accurate federal reports on a timely basis and federal programs were not properly monitored as to compliance with applicable laws and regulations. Refer to those findings for more detail.	In Process	2017-007
2016-008	**U.S. DEPARTMENT OF LABOR** **17.225 – Internal Control over Reporting Compliance** ***Internal control over reporting compliance*** Our procedures performed in the financial and performance reporting requirements we noted the following instances of noncompliance:	Partially Corrected	2017-008

FINDING NUMBER	FINDING OR CONDITION	CURRENT STATUS	REFER TO CURRENT YEAR FINDING
	• Reports ETA 581 Contributions Operation for the period ending in December 31, 2015 and March 31, 2016 were submitted to the Employment and Training Administration Offices with 5 days of delay.	In Process	2017-008
	• The report ETA 2208 for the period ending in June 30, 2016 was submitted with 2 days of delay.	Corrected	N/A
	In addition, as part of our internal control procedures we noted that the reports ETA 581 and ETA 2112 reports are prepared and submitted to the Federal government by the same employee. Such reports are not reviewed by an independent employee.	In Process	2017-008
2016-009	**U.S. DEPARTMENT OF LABOR** **17.225 – Unemployment Insurance** ***Internal Control over Cash Management*** Federal funds for unemployment benefits payments are requested by a specific employee. That employee determines the amount to be requested and performs the request. No review or approval is performed by another independent person.	Corrected	2017-009
2016-010	**U.S. DEPARTMENT OF LABOR** **17.225 – Unemployment Insurance** ***Internal Control and Compliance - Special Test and Provisions - Match with IRS 940 Tax Form*** During the fiscal year ended June 30, 2016, after multiple efforts realized, the **Department** was not able to complete the transmission of data required and to certify the federal government the total amount of contributions required to be paid by each taxpayer under state law for the calendar year and the amount of such payments. The **Department** does not have an internal control structure properly designed to comply with IRS requirements to perform the annual certification.	Corrected	N/A