

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Basic Financial Statements and  
Required Supplementary Information

June 30, 2017

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PO Box 5460  
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Glasgow 1890 College Park IV  
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## **INDEPENDENT AUDITORS' REPORT**

Mr. Eligio Hernández Pérez  
**Office for the Improvements of Public Schools**  
San Juan, Puerto Rico

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the **Office for the Improvements of Public Schools (OMEF, by its Spanish acronym)** (a component unit of the Commonwealth of Puerto Rico's Department of Education), an agency of the Commonwealth of Puerto Rico (the Agency), as of and for the year ended June 30, 2017, and the related notes to the financial statements which collectively comprise the OMEF'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 an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

## **Basis for Qualified Opinion**

We did not observe the taking of the physical inventories at June 30, 2017 (stated at \$1,374,328), in the General Fund; therefore, we were unable to satisfy ourselves about inventory quantities by means of other auditing procedures.

OMEF has not maintained adequate capital assets records for the year ended June 30, 2017, and we were unable to apply procedures to determine whether the opening balances in the financial statements as of July 1, 2016, were fairly presented in conformity with accounting principles generally accepted in the United States of America.

Because of the inadequacy of the accounting records in support to compensated absences and encumbrances, we were unable to obtain sufficient adequate audit evidence.

## **Qualified Opinion**

In our opinion, except for the effects of the matter described in the "Basis for Qualified Opinion" paragraph the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of the **Office for the Improvements of Public Schools**, 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.

## **Emphasis for Matter**

### Going Concern

The accompanying financial statements have been prepared assuming that the OMEF will continue as a going concern. As discussed in Note 8 to the financial statements, the OMEF is highly dependent on the Commonwealth of Puerto Rico (the Commonwealth) appropriations to finance its operations. The financial difficulties experienced by the Commonwealth, including the uncertainty as to its ability to fully satisfy its obligations, raises substantial doubt the OMEF's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

## **Change in Accounting Principle**

As described in Note 10 to the combined financial statements, the Corporation adopted the provisions of GASB No. 68, Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27, and the related GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to Measurement Date - an amendment to GASB Statement No. 68 effective July 1, 2016. OMEF's net position at the beginning of year has been adjusted for this change. Our opinion is not modified with respect to this matter.

## **Other Matters**

### Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the *Governmental Accounting Standards Board*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries 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.

## Other Matters, (Continued)

### GASB 68 Required Supplementary Information

The Corporation did not include the Schedule of Funding Progress for Retiree Health Plan (OPEB), that accounting principles generally accepted in the United States of America require to be presented to supplement the basic combined financial statements because the final audited pension information from the Employee Retirement System of the Government of the Commonwealth of Puerto Rico is not readily available. Such missing information, although not a part of the basic combined financial statements, is required to be an essential part of the financial reporting by the Governmental Accounting Standards Board who considers it an essential part of the financial reporting for placing the basic combined financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic combined 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 OMEP's financial statements as a whole. The introductory section, combining and individual nonmajor fund financial statements, and statistical section are presented for purposes of additional analysis and are not a required part of the financial statements. The combining and individual nonmajor fund financial statements are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements.

The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory and statistical sections have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on them.



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## **OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Management Discussion and Analysis

For the Year Ended June 30, 2017

As management of the Office for the Improvements of Public Schools (OMEP), we offer readers of the financial statements this narrative overview and analysis of the OMEP's financial performance during the fiscal year ended June 30, 2017. Please read in conjunction with OMEP financial statements.

### **Financial Highlights**

- ❖ As of June 30, 2017, the total assets amounted to \$24,250,267.
- ❖ Receivables as of June 30, 2017, amounted to \$16,566,607.
- ❖ The net position deficit of OMEP amounted to \$14,235,163 at the close of fiscal year 2017.

During the school year 2016-2017, the Government of Puerto Rico had one thousand three hundred and twenty-six (1,326) opened schools. Of this amount, nine hundred and seventy-four (974) public schools pertained to OMEP, amount which includes three hundred fifty-two (352) schools shared with the Puerto Rico Public Buildings Authority (PBA). To each of these schools OMEP provided routine maintenance services through municipal and/or private agreements. So far, 160 schools have been closed. OMEP will be providing the service to the closed ones in the maintenance of the green areas and fumigation until the assets are disposed.

### **Using this Annual Financial Statements**

This annual report is required supplementary information to the basic financial statements and is intended to serve as an introduction to the basic financial statements. The basic financial statements are comprised of three (3) components: government-wide financial statements, fund financial statements, and notes to the financial statements.

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

These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two (2) statements report OMEP' net position (deficit) and changes in them. OMEP's net position (the difference between assets and liabilities) may be used to measure the OMEP's financial health, or financial position. Over time, increases or decreases in OMEP's net position are one indicator of whether its financial health is improving or deteriorating.

The Statement of Net Position (Deficit) and the Statement of Activities and Change in Net Position (Deficit) are commonly divided into two kinds of activities: Governmental activities and Business-type activities. The OMEP reports all its activities as governmental activities.

## OFFICE FOR THE IMPROVEMENTS OF PUBLIC SCHOOLS

(A Component Unit of the Commonwealth of  
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Management Discussion and Analysis

For the Year Ended June 30, 2017

### **Fund Financial Statements**

OMEF operates under four (4) major funds: General Fund, QZAB Fund, Special Revenue Fund, and Other Fund.

Most of the basic services are reported in governmental funds, which focus on how money flows in and out of those funds, and the balances left at year-end that are available for spending. These funds are reported using the modified accrual basis of accounting, which measures cash and other financial assets that can readily be converted to cash. The governmental fund statements provide detailed short-term view of the OMEF's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the OMEF's activities. The relationship (or differences) between governmental activities (reported in the Statements of Net Position (Deficit) and the Statement of Activities and Change in Net Position (Deficit)) and governmental funds is described in the reconciliation at the bottom of the fund financial statements.

- ***Governmental Funds*** - The following are the governmental fund types presented in the financial statements as of and for the year ended June 30, 2017.
  - ❖ ***General Fund*** - Accounts for and reports all financial resources, except for those required in another fund. These operations consist of the general administration of OMEF.
  - ❖ ***QZAB Fund*** - Accounts for and reports the proceeds of bond issuance used for the improvements of schools.
  - ❖ ***Special Revenue Fund*** - Accounts for and reports the proceeds of specific revenue's sources that are restricted or committed for specified purposes such as federal grants and legislative resolutions.
  - ❖ ***Other Funds*** - Accounts for and reports other financial resources not included in the General Fund, Special Revenue Fund, or QZAB Fund.

### **Notes to the Financial Statements**

The notes to the financial statements provide information that is essential to a full understanding of the data provided in the government-wide financial statements and the fund financial statements.

### **Required Supplementary Information**

This Management's Discussion and Analysis and the Combining Financial Statements represent financial information required to be presented by accounting principles generally accepted in the United States of America. Such information provides users of this report with additional data that supplements the statement and notes.

The basic financial statements include a section of required supplementary information immediately following its notes. This section includes a supplemental schedule of expenditures by budget and actual budget basis-general fund, the Schedule of Statutorily Required Employer Contributions Pension Plan, and the Schedule of Proportionate Share of the Collective Net Pension Liability.

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Management Discussion and Analysis

For the Year Ended June 30, 2017

**Financial Analysis as a Whole**

The financial statements of OMEP are presented under the requirements of GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis-for State and Local Governments", which affects the way to prepare and present financial information. A condensed Statement of Net Position (Deficit) is presented below:

<u>Condensed Statement of Net Position</u>	<u>Years Ended June 30</u>		<u>Change</u>	
	<u>2017</u>	<u>2016</u>	<u>In Dollars</u>	<u>%</u>
		(Restated)		
Assets:				
Cash and Other Assets	\$ 7,683,660	\$ 5,924,843	\$ 1,758,817	29.69%
Receivables	16,566,607	15,088,538	1,478,069	9.80%
Total Assets	<u>\$ 24,250,267</u>	<u>\$ 21,013,381</u>	<u>\$ 3,236,886</u>	<u>15.40%</u>
Deferred Outflows of Resources	<u>\$ 5,606,061</u>	<u>\$ 2,535,867</u>	<u>\$ 3,070,194</u>	<u>121.07%</u>
Liabilities:				
Accounts Payable and Other Liabilities	\$ 8,196,579	\$ 10,159,824	\$(1,963,245)	-19.32%
Long Term Liabilities	34,776,096	23,282,041	11,494,055	49.37%
Total Liabilities	<u>\$ 42,972,675</u>	<u>\$ 33,441,865</u>	<u>\$ 9,530,810</u>	<u>28.50%</u>
Deferred Inflows of Resources	<u>\$ 1,118,816</u>	<u>\$ 966,160</u>	<u>\$ 152,656</u>	<u>15.80%</u>
Net Position:				
Invested in Capital Assets	\$ -	\$ 13,800	\$ (13,800)	-100.00%
Restricted	6,530,895	14,216,560	(7,685,665)	-54.06%
Unrestricted	(20,766,058)	(25,089,137)	4,323,079	-17.23%
Total Net Position	<u>\$ (14,235,163)</u>	<u>\$ (10,858,777)</u>	<u>\$ (3,376,386)</u>	<u>31.09%</u>

Unrestricted net assets can be used to finance "day-to-day" operations without constraints established by debt covenants, enabling legislation or other legal requirements.



**OFFICE FOR THE IMPROVEMENTS  
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Management Discussion and Analysis

For the Year Ended June 30, 2017

**Financial Analysis as a Whole, (Continued)**

**Statement of Net Position (Deficit) Comparison**

	2017	2016	Change
		(Restated)	
Total Assets	\$ 24,250,267	\$ 21,013,381	\$ 3,236,886
Deferred Outflows of Resources	5,606,061	2,535,867	3,070,194
Total Liabilities	(42,972,675)	(33,441,865)	(9,530,810)
Deferred Inflow of Resources	(1,118,816)	(966,160)	(152,656)
Net Position (Deficit)	\$ (14,235,163)	\$ (10,858,777)	\$ (3,376,386)

**Statement of Activities Comparison**

	2017	2016	Change
		(Restated)	
Revenues	\$ 39,494,455	\$ 35,143,872	\$ 4,350,583
Expenses	42,870,841	51,208,998	(8,338,157)
Change in Net Assets	\$ (3,376,386)	\$ (16,065,126)	\$ 12,688,740

**Governmental Funds**

OMEP uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The focus of OMEP's governmental funds is to provide information on near term inflows, outflows and balances of resources available for spending. In particular, unreserved fund balance may serve as a useful measure of the OMEP's net resources available at the end of a fiscal year.

**Request for Information**

This financial report is designed to provide our citizen, taxpayers, and creditors with a general overview of OMEP's finances and to demonstrate OMEP's accountability for the money it receives. If you have questions about this report, please contact OMEP's Finance Department at (787) 281-7575.

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Statement of Net Position (Deficit)

June 30, 2017

**ASSETS**

	<u>Governmental Activities</u>
Assets:	
Cash	\$ 6,309,332
Receivables:	
Due from PRDE	16,495,184
Other, Net	71,423
Inventories	<u>1,374,328</u>
Total Assets	24,250,267
Capital Assets, Net	-
Deferred Outflows of Resources:	
Contributions to Employees Retirement System	<u>5,606,061</u>
Total Assets and Deferred Outflows of Resources	<u><u>\$ 29,856,328</u></u>

**LIABILITIES AND NET POSITION**

Liabilities:	
Check Issued Over Bank Balance	\$ 708,520
Accounts Payable	2,794,385
Unearned Revenues	3,980,358
Current Pension Benefits Payable	713,316
Non-Current Pension Benefits Payable	2,225,316
Net Pension Liability	<u>32,550,780</u>
Total Liabilities	42,972,675
Deferred Inflows of Resources:	
Unamortized Investment in Employees Retirement System	1,118,816
Net Position (Deficit):	
Restricted	6,530,895
Unrestricted	<u>(20,766,058)</u>
	<u>(14,235,163)</u>
Total Liabilities, Deferred Inflows of Resources and Net Position	<u><u>\$ 29,856,328</u></u>

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Statement of Activities and Change in Net Position (Deficit)

For the Year Ended June 30, 2017

	<u>Expenses</u>	<u>Revenues Operating Grants</u>	<u>Net (Expenses) Revenues and Changes in Net Assets Governmental Activities</u>
Activities:			
Governmental:			
Administrative Support	\$ 42,028,096	\$ 39,424,599	\$ (2,603,497)
Construction and Maintenance of Schools	842,745	13,762	(828,983)
Total Expenditures	<u>\$ 42,870,841</u>	<u>\$ 39,438,361</u>	<u>(3,432,480)</u>
General Revenues:			
Interest Income			56,094
Total			<u>56,094</u>
Change in Net Position			(3,376,386)
Net Position at Beginning of Year, as Previously Reported			7,943,304
Prior Period Adjustment			<u>(18,802,081)</u>
Net Position (Deficit) at Beginning of Year, as Restated			<u>(10,858,777)</u>
Net Position (Deficit) at End of Year			<u>\$ (14,235,163)</u>

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Balance Sheet - Governmental Funds

June 30, 2017

**ASSETS**

	General Fund	QZAB Fund	Special Revenue Fund	Other Fund	Total Governmental Funds
Assets:					
Cash	\$ 6,303,919	\$ -	\$ -	\$ 5,413	\$ 6,309,332
Accounts Receivable	16,506,020	-	60,587	-	16,566,607
Due from Other Fund	298,820	-	-	-	298,820
Inventories	1,374,328	-	-	-	1,374,328
<b>Total Assets</b>	<b>\$ 24,483,087</b>	<b>\$ -</b>	<b>\$ 60,587</b>	<b>\$ 5,413</b>	<b>\$ 24,549,087</b>

**LIABILITIES AND FUND BALANCES**

Liabilities:					
Check Issued Over Bank Balance	\$ -	\$ 443,140	\$ 265,380	\$ -	\$ 708,520
Accounts Payable	2,585,684	95,353	50,434	62,914	2,794,385
Unearned Revenues	3,980,358	-	-	-	3,980,358
Due to General Fund	-	-	-	298,820	298,820
Pension Benefits Payable	713,316	-	-	-	713,316
<b>Total Liabilities</b>	<b>7,279,358</b>	<b>538,493</b>	<b>315,814</b>	<b>361,734</b>	<b>8,495,399</b>
Fund Balance:					
Nonspendable:					
Inventory Reserve	1,374,328	-	-	-	1,374,328
Restricted:					
Capital Project	-	-	-	-	-
Committed:					
General Fund	6,078,984	-	-	-	6,078,984
Capital Project	-	-	-	-	-
Special Projects	-	-	271,427	-	271,427
Assigned:					
General Fund	180,484	-	-	-	180,484
Unassigned	9,569,933	(538,493)	(526,654)	(356,321)	8,148,465
<b>Total Fund Balance (Deficit)</b>	<b>17,203,729</b>	<b>(538,493)</b>	<b>(255,227)</b>	<b>(356,321)</b>	<b>16,053,688</b>
<b>Total Liabilities and Fund Balance</b>	<b>\$ 24,483,087</b>	<b>\$ -</b>	<b>\$ 60,587</b>	<b>\$ 5,413</b>	<b>\$ 24,549,087</b>

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Reconciliation of the Balance Sheet of  
Governmental Funds to the Statement of Net Position (Deficit)

June 30, 2017

Governmental Funds Balance	\$ 16,053,688
Amounts Reported for Governmental Activities in the Statement of Net Position (Deficit) are Different Because:	
Non-Current Pension Benefits Payable	(2,225,316)
Net Pension Liability	(32,550,780)
Deferred Outflows and Inflows of Resources Related to Pensions are Applicable to Future Reporting Periods and, therefore, are Not Reported in the Funds.	<u>4,487,245</u>
Net Position (Deficit) of Governmental Activities	<u><u>\$ (14,235,163)</u></u>

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Statement of Revenues, Expenditures and Changes  
in Fund Balances - Governmental Funds

For the Year Ended June 30, 2017

	General Fund	QZAB Fund	Special Revenue Funds	Other Fund	Total Governmental Funds
<b><u>REVENUES</u></b>					
Interest	\$ 4,521	\$ 51,573	\$ -	\$ -	\$ 56,094
Appropriations from PBA	75,614	-	-	-	75,614
Appropriations from PRDE	39,346,559	-	-	-	39,346,559
Other Income	2,426	-	-	13,762	16,188
	<u>39,429,120</u>	<u>51,573</u>	<u>-</u>	<u>13,762</u>	<u>39,494,455</u>
<b><u>EXPENDITURES</u></b>					
Payroll and Payroll Taxes	6,766,926	-	-	-	6,766,926
Utilities and Public Services	214,299	-	-	-	214,299
Maintenance, Construction and Improvement of Public Schools	24,406,432	572,731	261,665	8,349	25,249,177
Rent Expense	131,398	-	-	-	131,398
Transportation Expenses	454,538	-	-	-	454,538
Professional Services	728,427	1,425	-	-	729,852
Purchase of Equipment	214,518	-	-	-	214,518
Materials and Supplies	585,256	-	(65,440)	-	519,816
	<u>33,501,794</u>	<u>574,156</u>	<u>196,225</u>	<u>8,349</u>	<u>34,280,524</u>
Excess (Deficit) of Revenues Over Expenditures	<u>5,927,326</u>	<u>(522,583)</u>	<u>(196,225)</u>	<u>5,413</u>	<u>5,213,931</u>
Other Financing Sources (Uses):					
Transfer In	2,439,073	-	165,722	15,481	2,620,276
Transfer Out	(2,263,675)	(61,651)	(165,722)	(129,228)	(2,620,276)
	<u>175,398</u>	<u>(61,651)</u>	<u>-</u>	<u>(113,747)</u>	<u>-</u>
Net Change in Fund Balances	6,102,724	(584,234)	(196,225)	(108,334)	5,213,931
Fund Balance at Beginning of Year	11,101,005	45,741	(59,002)	(247,987)	10,839,757
Fund Balance (Deficit) at End of Year	<u>\$ 17,203,729</u>	<u>\$ (538,493)</u>	<u>\$ (255,227)</u>	<u>\$ (356,321)</u>	<u>\$ 16,053,688</u>

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

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

For the Year Ended June 30, 2017

Net Change in Fund Balances-Total Governmental Funds \$ 5,213,931

Amounts Reported for Governmental Activities in the Statement of  
Activities are Different Because:

Governmental Funds Report Capital Assets 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:

Current Year Depreciation and Acquisition of Equipment are as Follows:

Current Year Depreciation	(21,205)
Acquisition of Equipments	7,405

Contributions to the Pension Plan in Current Fiscal Year are Deferred  
Outflows of Resources on the Statement of Net Position.

(9,261,454)

Governmental Funds Report the Current Amount of Enactment of  
Act. No. 70, Voluntary Termination Benefits. However, the Financial  
Impact Resulting of Benefits to Participants was the Recognition of a  
Pension Benefits Liability in the Statement of Net Position.

684,937

Change in Net Position of Governmental Activities

\$ (3,376,386)

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

**OFFICE FOR THE IMPROVEMENTS  
OF PUBLIC SCHOOLS**

(A Component Unit of the Commonwealth of  
Puerto Rico's Department of Education)

Notes to Financial Statements

June 30, 2017

**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

Organization

The **Office for the Improvements of Public Schools (OMEP)** is a blended component unit of the Commonwealth of Puerto Rico's Department of Education, created by means of the Joint Resolution No. 3 of August 28, 1990 for the purpose of setting in function an accelerated program for the repair and the betterment of the schools structures and for the purchase of books, furniture, materials, and didactic equipment necessary for the process of teaching.

On January 26, 1995, by means of the Administrative Bulletin No. OE-1195-11, the direction and administration of OMEP were transferred to the Puerto Rico Department of Education (PRDE), and the Secretary of Education (Secretary) was appointed as the Executive Director.

On April 30, 1996, the Secretary converted the regional offices of the School Buildings Maintenance Unit of the Department in regional offices of OMEP, transferring the personnel, the materials, the equipment and the supplies, that it had at that moment, to the regional offices.

At June 30, 2017, the services offered by OMEP were conducted from a central office and seven regional offices as follows: San Juan, Caguas, Bayamón, Arecibo, Ponce, Mayagüez, and Humacao.

The operations of OMEP are administered by a General Manager appointed by the Executive Director. The regional offices are administered by a Regional Director appointed by the General Manager.

Basic Financial Statements

The financial statements of OMEP have been prepared in accordance with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the standard-setting body for governmental accounting and financial reporting. The GASB periodically updates its existing Governmental Accounting and Financial Reporting Standards, which, along with subsequent GASB pronouncements (Statements and Interpretations), constitutes U.S Generally Accepted Accounting Principles (GAAP) for governmental units.

The basic financial statements include both government-wide and fund financial statements. Both levels of statements categorize primary activities as governmental type, which are primarily supported by taxes and intergovernmental revenues.

Basis of Accounting and Measurement Focus

Basis of accounting refers to the point at which revenues and expenditures are recognized and reported.

The fund financial statements are presented on the modified accrual basis of accounting. Accordingly, revenues are recorded when they are measurable and available to finance current expenditures of the fund, during the current period or after, but in time to pay for current year-end liabilities. Expenditures are recorded normally in the accrual basis as they are measurable when they are incurred, affected by the measurement focus applied.



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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Basis of Accounting and Measurement Focus, (Continued)

Government-wide financial statements are presented on the accrual basis of accounting. Accordingly, revenues are recognized in the period they are earned while expenditures are recognized when incurred. The elements in the accrual basis of accounting are: (1) deferral of expenditures and the subsequent amortization of deferral costs, (2) the deferral of revenues until they are earned, (3) capitalization of certain expenditures, and (4) accrual of revenues that have been earned, and expenses that have been incurred.

The measurement focus is concerned with the inflow and outflow of resources that affect the entity. The flow of economic resources is applied on an accrual basis and the flow of total financial resources and the flow of current financial resources are used in the modified accrual basis.

Federal financing assistance received from the federal government is recorded following the applicable legal and contractual requirements. Essentially, revenues are recognized based upon the expenditures recorded. This occurs when expenditures are incurred for the specific purpose of the project. Revenues are revocable only for failure to comply with prescribed compliance requirements.

Management Discussion and Analysis

This consists of a narrative introduction and analytical overview of OMEP's financial activities. This analysis is similar to the analysis that the private sector provides in their annual reports.

Basis of Presentation - Fund Accounting

The financial report of OMEP consists of a Management Discussion and Analysis (MD&A), basic financial statements, notes to the financial statements and required supplementary information other than the MD&A. Following is a summary presentation of each, including the measurement focus and basis of accounting.

The accounts of OMEP are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, reserves, fund equity, revenues, and expenditures. Funds are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. Governmental funds include the general, special revenue, and other funds. Account groups are established to maintain accountability over capital assets or long-term general obligations.

Government-Wide Financial Statements

The government-wide financial statements include a Statement of Net Position (Deficit) and a Statement of Activities and Changes in Net Position (Deficit). These statements are presented on an "economic resources" measurement focus and the accrual basis of accounting. All transactions and events that affect the total economic resources (net position/(deficit)) during the period are reported. Fiduciary activities, if any, whose resources are not available to finance government programs, are excluded from the government-wide statements. The effect of Inter-fund activities is eliminated.

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Government-Wide Financial Statements, (Continued)

The Statement of Net Position (Deficit) incorporates all capital (long lived) assets and receivables as well as long term liabilities and obligations. The Statement of Activities and Change in Net Position (Deficit) reports revenues and expenses in a format that focus on the net cost of each function of OMEP. Both the gross and net cost of the function, which is otherwise being supported by the general government revenues is compared to the revenues generated directly by the function. This Statement of Activities and Change in Net Position (Deficit) reduces gross expenses, including depreciation, by related program revenues, operating and capital grants, and contributions. Program revenues must be directly associated with the function.

The types of transactions included as program revenues are charges for services, fees, licenses and permits; operating grants, which include operating-specific and discretionary (either operating or capital) grants; and capital grants, which are capital-specific grants. Internally dedicated resources are reported as general revenues rather than as program revenues. Revenues on both operating and capital grants are recognized when all eligibility requirements (which include time requirements) imposed by the provider have been met.

For certain expenditure-driven grants revenue is recognized after allowable expenditures are incurred. As a policy, indirect expenses in the Statement of Activities and Change in Net Position (Deficit) are not allocated. OMEP first uses restricted assets for expenses incurred for which both restricted and unrestricted assets are available.

OMEP's Net Position (Deficit) is classified as follows:

- Net Investment in Capital Assets - This represents the OMEP's total investment in capital assets, net of the corresponding related debt.
- Restricted - This represents funds received through legislative resolution and/or appropriations. The proceeds are to be used for repair and maintenance of schools.
- Unrestricted - Since there were minimal revenues and the OMEP is incurring expenses in excess of the legislative appropriations, the OMEP has a deficit in the unrestricted balance.

Governmental Fund Financial Statements

The Governmental Fund Financial Statements include a Balance Sheet and a Statement of Revenues, Expenditures and Changes in Fund Balances with one column for the general fund, one column for each major fund and one column combining all non-major governmental funds. Major funds are determined based on a minimum criterion, which is a percentage of the assets, liabilities, revenues or expenditures (for Commonwealth Legislature Resolutions Fund and Debt Service Fund) or based on Management official's criteria. OMEP reports the following major governmental funds:

- General Fund - Accounts for and reports all financial resources, except those required in another fund. These operations consist of the general administration of OMEP.

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Governmental Fund Financial Statements, (Continued)

- Special Revenue Fund - Accounts for and reports the proceeds of specific revenue's sources that are restricted or committed for specific purpose such as federal grants and legislative resolutions.
- QZAB Fund - Accounts for and reports the proceeds of bond issuance used for the improvements of schools.
- Other Fund - Accounts for and reports other financial resources not included in the General Fund, Special Revenue Fund, or QZAB Fund.

Fund Balance - Generally, fund balance represents the difference between the assets and liabilities under the current financial resources measurement focus of accounting. In the fund financial statements, governmental funds report net position classifications that comprise a hierarchy based primarily on the extent to which OMEP is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. Fund balances are classified as follows:

- Nonspendable - Fund balances are reported as "non-spendable" when amounts cannot be spent because they are either (a) not in spendable form (i.e., items that are not expected to be converted to cash) or (b) legally or contractually required to be maintained intact.
- Restricted - Fund balances are reported as "restricted" when there are limitations imposed on their use either through the enabling legislation adopted by OMEP or through external restrictions imposed by creditors, grantors or law or regulations of other governments.
- Committed - Fund balances are reported as "committed" when they can be used only for specific purposes pursuant to constraints imposed by formal action of the governing board of OMEP through the adoption of a resolution. Only the governing board of OMEP may modify or rescind the commitment.
- Assigned - Fund balances are reported as "assigned" when amounts are constrained by OMEP's intent to be used for specific purposes but are neither restricted nor committed. Through resolution, the governing board of OMEP has authorized OMEP's Executive Director to declare funds as assigned.
- Unassigned - Fund balances are reported as "unassigned" when the balances do not meet any of the above criteria. OMEP reports unassigned fund balance only in the general fund. Negative unassigned fund balance may be reported in all funds.

Committed, assigned and unassigned fund balances are collectively considered to be unrestricted funds.

Net Position Flow Assumptions – It is OMEP's policy to use restricted resources first before using unrestricted resources.

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Fund Balance Flow Assumptions - When both restricted and unrestricted amounts are available for use for specific expenditures, it is OMEP's policy to use restricted amounts first and then unrestricted amounts as they are needed. It is OMEP's policy to use unrestricted fund balances in the following order: a. Committed, b. Assigned, c. Unassigned.

Cash and Cash Equivalents

Cash is comprised of cash on hand and demand deposits held in the Government Development Bank of Puerto Rico (GDB) and in commercial banks. OMEP maintains separate cash accounts for each federal award program.

Inventories

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

OMEP uses the purchase method of accounting where purchases of inventories are recognized as expenditures when the goods are received, and the transaction is vouched. Generally accepted accounting principles allows the purchase method to account for inventories, but when the inventory amount is significant, the amount must be reported in the government's fund balance sheet.

An estimated value for inventories is reported as both, an asset and a fund balance reserve in the General Fund.

Capital Assets

Capital assets are defined by OMEP as assets with an initial, individual cost of more than \$500 and an estimated useful life of more than one year. Purchased or constructed capital assets are reported at cost or estimated historical cost. Maintenance and repairs that do not extend the life of the asset are charged to expense.

Depreciation expense is not reported in governmental funds. All reported capital assets are depreciated using the straight-line method over the following estimates useful lives:

<u>Assets</u>	<u>Years</u>
Office Equipment	5 years
Motor Vehicles	5-10 years

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Risk Management

The Secretary of the Puerto Rico Treasury Department is the agent with the responsibility of obtaining and payment of insurance for the PRDE that includes OMEP for loss or damage to property and general liability.

Compensated Absences

OMEP accrues accumulated unpaid vacation and sick leave and associated employee-related costs when earned (or estimated to be earned) by the employee.

From July 1, 2016 and until April 28, 2017, with the exceptions explained below, OMEP employees were granted vacations and sick leave in accordance with the "*Reglamento de Personal del Departamento de Educación de Puerto Rico* (Personnel Regulations). Law No. 66 of April 26, 2014 for Fiscal and Operational Sustainability of the Government of the Estado Libre Asociado de Puerto Rico (Law 66-2014) limited the accrual of vacation and sick leave, and the payment for excess days accrued.

Law No. 8 of February 4, 2017 for the Administration and Transformation of Human Resources in the Government of Puerto Rico (Law 8-2017) and Law 26 of April 29, 2017 for Compliance with the Fiscal Plan (Law 26-2017) established new parameters for the accrual of vacations and sick leave. Later, as per Law 32 of January 21, 2018 (Law 32-2018), OMEP became exempt from the application of Law 8-2017 and as a consequence, the parameters for the accrual of vacation days changed.

During year 2017, OMEP's employees were granted vacations and sick leave as follows:

Vacations

For the period between July 1, 2016 and April 28, 2017, except for employees hired between February 4 and April 28, 2017, vacations were accrued as follows:

Period of Services as Corporation Employee, per Type of Employment	Monthly Accrual	Maximum Annual Balance
<b>Regular Employment:</b>		
One (1) Year or Less	1.25 days	15 days
More than One (1), Less than Four (4) Years	1.75 days	42 days
Four (4) Years and Over	2.00 days	48 days
<b>Temporary Employment:</b>		
One (1) Year or Less	1.00 days	12 days
More than One (1) Year	1.25 days	30 days

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Vacations, (Continued)

Accrued days in excess of the maximum annual balance and up to sixty (60) days will be payed yearly.

Employees hired between February 4 and April 28, 2017, accrued two (2) days monthly during that period only, and had the right to be paid during the fiscal year for the excess of sixty (60) days accrued, only if OMEP had sufficient funds to make such payment.

For the period between April 29, 2017 to January 20, 2018, all employees accrued 1.25 vacation days monthly, equivalent to fifteen (15) days annually, and up to a maximum of sixty (60) days. Accrued days in excess of sixty (60) days cannot be paid. Any excess of sixty (60) days accrued by employees prior to April 29, 2017 had to be used by December 31, 2017.

After January 21, 2018 and while Law 26-2017 remains in effect, vacation days are accrued as per the Personnel Regulations. However, any excess of sixty (60) days cannot be paid.

Sick leave

For the period between July 1, 2016 and April 28, 2017, employees accrued sick leave as follows:

Type of Employment	Monthly Accrual	Maximum Annual Balance
Regular Employment	1.25 days	60 days
Temporary Employment	1.00 days	30 days

During this period, employees hired prior to February 3, 2017, may accrue up to sixty (60) days for regular employment and up to thirty (30) days for temporary employment, and any days accrued in excess will be paid annually only if OMEP has sufficient funds. Employees hired between February 4 and April 28, 2017, may accrue up to ninety (90) days, and any days in excess will be paid annually only if OMEP has sufficient funds.

After April 29, 2017 and while Law 26-2017 remains in effect, the following applies to all OMEP employees:

	Monthly Accrual	Maximum Annual Balance
Regular Employment	1.25 days	60 days
Temporary Employment	1.00 days	30 days

Days in excess of the ninety (90) day accrual limit cannot be paid.

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**1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, (Continued)**

Sick leave, (Continued)

OMEF accrues a liability for compensated absences which meet the following criteria:

1. OMEF's obligations relating to employee's rights to receive compensation for futures absences are attributable to employee's services already rendered.
2. The obligation relates to right that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonably estimated.

In accordance with the above criteria and requirements as established by GASB No. 16; OMEF has accrued a liability for compensated absences, which has been earned but not taken by OMEF's employees. For the government-wide statements, the current portion is the amount estimated to be used in the following years. For the governmental funds statements, the current portion for compensated absences is only considered and represents a reconciling item between the fund level and government-wide presentation.

Budgetary Accounting

OMEF prepares an internal annual budget for administrative purposes. The budget is not integrated with the accounting system; therefore, the financial statements are not presented in comparison budget to actual.

**2. FUND BALANCE REPORTING**

Substantially, all the restricted fund balances as of June 30, 2017, are related to special revenue activity, and proceeds from Qualified Zone Academy Bonds (QZAB) 2004 issuance. Such restricted balances may only be utilized in accordance with the purposes established by regulations, placed on the use of resources, by the contributors. Restricted funds are in contrast to unassigned funds over which the governing board retained full control to use in achieving of its purposes.

OMEF maintains an encumbrance system for all disbursements made during the course of its operations, except for payroll and related expenses. As part of the encumbrances made during the year, OMEF encumbered \$6,078,984 and \$271,427 for General Fund and the Special Revenue Fund, respectively.

OMEF maintains separate cash accounts for each federal awards program. This cash is restricted to be used only for federal awards purposes. Also, OMEF maintains separate cash accounts for other non-federal programs.

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**3. DEPOSITS**

OMEF maintains its cash in bank deposit accounts at high credit qualified financial institutions.

	Book Balance			Bank Balance
	Unrestricted	Restricted	Total	
Deposits Commercial Banks	\$ 5,898,497	\$ 405,422	\$ 6,303,919	\$ 10,744,502
Petty Cash	200	-	200	-
Total	<u>\$ 5,898,697</u>	<u>\$ 405,422</u>	<u>\$ 6,304,119</u>	<u>\$ 10,744,502</u>

OMEF follows the provisions of GASB Statement No. 40 (GASB No. 40), *Deposit and Investment Risk Disclosure, an Amendment to GASB Statement No.3*. Accordingly, the following is essential information about credit risk, interest rate risk, custodial credit risk, and foreign exchange exposure of deposits and investments of OMEF at June 30, 2017:

- **Credit Risk** - This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. At June 30, 2017, OMEF has cash in a commercial bank, which are insured by the Federal Deposit Insurance Corporation (FDIC) up to a maximum of \$250,000. No investments in debt or equity securities were made during the fiscal year ended June 30, 2017; however, the amounts in excess of the FDIC coverage amounted to \$10.5 million, approximately. Therefore, OMEF's management has concluded that the credit risk related to any possible loss related to defaults by commercial and government banks on the OMEF's deposits is considered high at June 30, 2017.
- **Interest Rate Risk** - This is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. OMEF manages its exposure to declines in fair values by: (1) not including debt or equity investments in its investments portfolio at June 30, 2017, (2) limiting the weighted average maturity of its investments in certificates of deposit to periods of three months or less, and (3) keeping most of its banks deposits and certificates of deposit in interest bearing accounts generating interest at prevailing market rates. At June 30, 2017, the interest rate risk associated with the OMEF's cash and cash with fiscal agents are considered low since they have no investment portfolio.
- **Custodial Credit Risk** - In the case of deposits, this is the risk that in the event of a bank failure, OMEF's deposits may not be recovered. At June 30, 2017, OMEF has balances deposited in commercial banks amounting to \$10.5 million approximately, which are insured by the FDIC up to a maximum of \$250,000.



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**3. DEPOSITS, (Continued)**

- Custodial Credit Risk, (Continued) - It is management's policy to only maintain deposits in banks affiliated to FDIC to minimize the custodial credit risk, except for GDB. Therefore, OMEP's management has concluded that at June 30, 2017, the custodial credit risk associated with OMEP's cash and cash with fiscal agents is considered high.
- Foreign Exchange Risk - This is the risk that changes in exchange rates will adversely affect the value of an investment or a deposit. OMEP is prevented from investing in foreign securities or any other types of investments for which foreign exchange risk exposure may be significant. Accordingly, management has concluded that the foreign exchange risk related to the OMEP's deposits is considered low at June 30, 2017.

**4. CAPITAL ASSETS**

OMEP's capital assets activity for the year ended June 30, 2017, was as follows:

	Beginning Balance	Additions	Ending Balance
Capital Assets Being Depreciated:			
Equipment	\$ 1,752,342	\$ 7,405	\$ 1,759,747
Motor Vehicles	2,066,925	-	2,066,925
Total Capital Assets	3,819,267	7,405	3,826,672
Less Accumulated Depreciation:			
Equipment	(1,738,542)	(21,205)	(1,759,747)
Motor Vehicles	(2,066,925)	-	(2,066,925)
Total Accumulated Depreciation	(3,805,467)	(21,205)	(3,826,672)
Net Capital Assets	<u>\$ 13,800</u>	<u>\$ (13,800)</u>	<u>\$ -</u>

**5. COMMITMENTS AND CONTINGENCIES**

OMEP participates in federally assisted grant programs. These programs are subject to program compliance audits by the grantors or their representatives. Accordingly, the amount of expenditures which may be disallowed by the granting agencies, if any, will be established at some future date. However, OMEP's Management expects such amounts, if any, to be immaterial.

OMEP is a defendant in various pending lawsuits. They are primarily related to worker/employer and contracts disputes. As of June 30, 2017, OMEP, based on legal advice, has recorded a liability of \$761,429 for probable loss on those claims, which has been recorded as part of the Accounts Payable in the accompanying financial statements.

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**5. COMMITMENTS AND CONTINGENCIES, (Continued)**

OMEPE's main office is located on a facility under an operating lease agreement which provides for monthly rental payments of \$10,950. The agreement was renewed on January 15, 2014 for a period of five years ending on January 14, 2019. Total expenditures for the year ended June 30, 2017 related to this agreement amounted to approximately \$131,000.

Minimum future rental payments for the next three (3) years under this agreement are summarized as follows:

<u>Year Ending June 30,</u>		
2018	\$	131,400
2019	\$	76,650

**6. VOLUNTARY TERMINATION BENEFITS**

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 OMEPE. Act No. 70 established that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited service in the Retirement System of the Government of the Commonwealth of Puerto Rico (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, OMEPE 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.

Economic incentives are available to eligible employees who have less than 15 years of credited service 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. 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 OMEPE.

The Voluntary Termination Benefits are the responsibility of the Department of Education of Puerto Rico. The financial impact resulting for the benefits granted to participants of OMEPE on this program was the recognition of a liability of \$2,944,465 as of June 30, 2017. At June 30, 2017, the unpaid long-term benefits granted on this program were discounted at 1.84%.

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**7. RETIREMENT PLAN**

The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (the ERS) is a trust created by the Legislature of the Commonwealth of Puerto Rico (the Commonwealth) pursuant to Act No. 447 on May 15, 1951 (Act No. 447), as amended, to provide pension and other benefits to retired employees of the Commonwealth, its public corporations and municipalities of Puerto Rico.

The System administers different benefit structures pursuant to Act No. 447, as amended, including a cost-sharing, multi-employer, defined benefit program, a defined Contribution program (System 2000 program) and a contributory hybrid program. Benefit provisions vary depending on a member's date of hire. Substantially all full-time employees of the Commonwealth and its instrumentalities (73 Commonwealth agencies, 78 municipalities, and 55 public corporations, including the System) are covered by the System. Membership is mandatory for all regular, appointed, and temporary employees of the Commonwealth and the Commonwealth's public corporation at the date of employment. Membership is optional for the Governor of the Commonwealth, Commonwealth secretaries, head of public agencies and instrumentalities, among others.

The benefits provided to members of the System are established by Commonwealth law and may be amended only by the Legislature with the Governor's approval. Act No. 3 of April 4, 2013 (Act No. 3), in conjunction with other recent funding and design changes, provided for a comprehensive reform of the System.

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

- Members of Act No. 447 are generally those members hired before April 1, 1990.
- Members of Act No. 1 of February 16, 1990 (Act No 1) are generally those members hired on or after April 1, 1990 and on or before December 31, 1999.
- Members of Act No. 305 of September 24, 1999 (Act No. 305 or System 2000) are generally those members hired on or after January 1, 2000 and on or before June 30, 2013.

All regular employees hired for the first time on or after July 1, 2013, and former employees who participated in the defined benefit program and the System 2000 program, and were rehired on or after July 1, 2013, become members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who at June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program are pooled and invested by the System. Future benefit payments will be paid from the same pool of assets.

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**7. RETIREMENT PLAN, (Continued)**

***Service Retirement Eligibility Requirements***

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

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

<b>Date of Birthday</b>	<b>Attained Age as of June 30, 2013</b>	<b>Retirement Eligibility Age</b>
July 1, 1957 or Later	55 or Less	61
July 1, 1956 to June 30, 1957	56	60
Before July 1, 1956	57 and Up	59

Eligibility for Act No 1 Members: Act No. 1 members who were eligible to retire as of June 30, 2013, continue to be eligible to retire at any time. Prior to July 1, 2013, Act No. 1 members could retire upon (1) attainment of age 55 with 25 years of credited service or (2) attainment of age 65 with 10 years of credited service.

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

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**7. RETIREMENT PLAN, (Continued)**

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

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

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

***Service Retirement Annuity Benefits***

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

Accrued Benefit as of June 30, 2013 for Act No. 447 Members - The accrued benefit as of June 30, 2013, shall be determined based on the average compensation, as defined, for Act No. 447 members, the years of credited service, and the attained age of the member all as of June 30, 2013.

If the Act No. 447 member had at least 30 years of credited service as of June 30, 2013, the accrued benefit equals 66% of average compensation if the member was under age 55 as of June 30, 2013, or 75% of average compensation if the member was at least age 56 as of June 30, 2013. For participants selecting to coordinate with social security (the Coordination Plan), the benefit is re-calculated at the Social Security Retirement Age (SSRA), as defined, as 1.6% of average compensation up to \$6,600 multiplied by years of credited service, up to 30 years, plus 65% (75% if member was at least age 55 as of June 30, 2013) of average compensation in excess of \$6,600.

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

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**7. RETIREMENT PLAN, (Continued)**

If the Act No. 447 member had less than 30 years of credited service as of December 31, 2013, the accrued benefit equals 1 of average compensation multiplied by years of credited service up to 20 years, plus 2% of average compensation multiplied by years of credited service in excess of 20 years. Maximum benefit is 75% of average compensation. The benefit is actuarially reduced for each year payment commences prior to age 58. For participants selecting the Coordination Plan, the basic benefit is re-calculated at SSRA as 1% of average compensation up to \$6,600 multiplied by years of credited service up to 20 years, plus 1 of average compensation up to \$6,600 multiplied by years of credited service in excess of 20 years, plus 1.50/0 of average compensation in excess of \$6,600 multiplied by years of credited service up to 20 years, plus 2.0% of average compensation in excess of \$6,600 multiplied by years of credited service in excess of 20 years. The benefit is actuarially reduced for each year payment commences prior to age 58.

Accrued Benefit as of June 30, 2013 for Act No. 1 Members - The accrued benefit as of June 30, 2013, shall be determined based on the average compensation for Act No. 1 members, the years of credited service, and the attained age of the member all as of June 30, 2013. The accrued benefit equals 1 of average compensation multiplied by years of credited service. The benefit is actuarially reduced for each year payment commences prior to age 65.

***Contributions***

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

Employer Contributions - Effective July 1, 2011, employer contributions are 9.275% of compensation. For the next four fiscal years effective July 1, employer contributions will increase annually by 1% of compensation. For the five fiscal years thereafter, employer contributions will increase annually by 125% of compensation, reaching an employer contribution rate of 20.525% of compensation effective July 1, 2020.

Supplemental Contributions from the Commonwealth's General Fund - Effective July 1, 2013, the System will receive a supplemental contribution of \$2,000 (of which \$800 corresponds to the pension plan and \$1,200 corresponds to the post employment healthcare benefits plan) each fiscal year for each pensioner (including beneficiaries receiving survivor benefits) who was previously benefitting as an Act No. 447 or Act No. 1 member while an active employee. This supplemental contribution will be paid by the Commonwealth's General Fund for former government and certain public corporations without own treasuries employees or by certain public corporations with own treasuries or municipalities for their former employees.

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**7. RETIREMENT PLAN, (Continued)**

Additional Uniform Contribution - The additional uniform contribution will be certified by the external actuary of the System each fiscal year from 2014-2015 through 2032-2033 as necessary to avoid having the projected gross assets of the System, during any subsequent fiscal year, to fall below \$1 billion. The additional uniform contribution is to be paid by the Commonwealth's General Fund, public corporations with their own treasuries, and municipalities. The additional uniform contribution determined for fiscal years 2014-2016 was \$120 million and for fiscal year 2017 was \$596 million, payable at the end of each fiscal year. The additional uniform contribution was eliminated in June 2017.

In June 2012, the GASB issued Statement No. 68, "*Accounting and financial Reporting for Pensions*", effective for OMEP fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by OMEP to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position.

The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year-end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plans assets are not available.

The actuarial valuation of the Basic System Benefits and System Administered Benefits as of June 30, 2016, (most recently available) reflects a fiduciary net position (deficit) of \$1,265,885,000, total pension liability of \$36,432,873,000 and a net pension liability of \$37,698,758,000.

At June 30, 2017, OMEP reports a liability of \$32,550,780 for its proportionate share of the Net Pension Liability. The Net Pension Liability was measured as of June 30, 2016 and the total pension liability used to calculate the Net Pension Liability was determined by an actuarial valuation as of that date. OMEP's proportion of the Net Pension Liability was based on a projection of OMEP's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. At June 30, 2016, OMEP's proportion was 0.086344%.

ERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in September 2016. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, ERS expects to continue using a discount rate net of administrative expenses for GASBS' No. 67 and 68 calculations through at least the 2016-2017 fiscal years. ERS will continue to check the materiality of the difference in calculation until such time as actuarial have changed his methodology.

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**7. RETIREMENT PLAN, (Continued)**

For the year ended June 30, 2017, OMEP recognized pension expense of \$9,261,454 with the effect of the application of GASB No. 68 and a Net Pension Liability of \$32,550,780, determined as follows:

	<b>Total Pension Liability</b>	<b>Plan Fiduciary Net Position</b>	<b>Net Pension Liability</b>	<b>Proportional Share</b>
Beginning Balance	\$ 32,669,162,000	\$ (668,273,000)	\$ 33,337,435,000	\$ 28,785,020
Change for the year:				
Service Cost	496,732,000	-	496,732,000	428,900
Interest on Total Pension Liability	1,230,798,000	-	1,230,798,000	1,062,726
Effect of Plan Changes	-	-	-	-
Effect of Economic/Demographic (Gains) of Losses	(249,935,000)	-	(249,935,000)	(215,805)
Effect of Assumptions				
Changes or Inputs	3,853,693,000	-	3,853,693,000	3,327,450
Benefit Payments	(1,567,577,000)	(1,567,577,000)	-	-
Administrative Expenses	-	(27,670,000)	27,670,000	23,892
Other Expenses	-	(9,401,000)	9,401,000	8,117
Costs of Bonds	-	(196,211,000)	196,211,000	169,417
Member Contributions	-	333,633,000	(333,633,000)	(288,074)
Net Investment Income	-	90,137,000	(90,137,000)	(77,828)
Employer Contributions	-	779,477,000	(779,477,000)	(673,035)
Ending Balance	<u>\$ 36,432,873,000</u>	<u>\$ (1,265,885,000)</u>	<u>\$ 37,698,758,000</u>	<u>\$ 32,550,780</u>

***Deferred Outflows of Resources and Deferred Inflows of Resources***

At June 30, 2017, OMEP reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<b>Deferred Outflows of Resources</b>	<b>Deferred Inflows of Resources</b>
Differences Between Expected and Actual Experience	\$ 4,964,998	\$ 176,127
Changes of Assumptions	26,613	446,871
Net Difference Between Projected and Actual Investments		
Earnings on Pension Plan Investments	-	495,818
Contributions Made after Measurement Date	614,450	-
	<u>\$ 5,606,061</u>	<u>\$ 1,118,816</u>



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**7. RETIREMENT PLAN, (Continued)**

Amounts reported as deferred outflows of resources and deferred inflows of resources (excluding employer specific amounts) related to pensions at June 30, 2016 will be recognized in pension expense as follows:

Year Ending June 30,	Amount
2017	\$ 509,051
2018	509,051
2019	531,328
2020	537,046
2021	281,056
	\$ 2,367,532

***Actuarial Methods and Assumptions***

The total pension liability was determined by an actuarial valuation as of July 1, 2016, calculated based on the discount rate and actuarial assumptions shown below and was then projected forward to June 30, 2016. The significant actuarial assumptions used to determine the standardized measure of the pension benefits obligation as of June 30, 2016 are summarized below.

- Investment Return: 6.55% per annum, net of investment expenses. Based on the System's investment policy, including target asset allocation and expectations regarding the loan portfolio, and Milliman's capital market assumptions as of June 30, 2016.
- Municipal Bond Rate: 2.85% per annum (Bond Buyer General Obligation 20-Bond Municipal Bond Index)
- GASB 67 discount rate: 2.85% per annum
- Compensation Increases: 3.0% per year. No compensation increases are assumed until July 1, 2021 as a result of the Act 3-2017 four-year extension of the Act 66-2014 salary freeze and the current general economy. Based on professional judgment and System input.
- Defined Contribution Hybrid Contribution Account: Member contributions to the Defined Contribution Hybrid Contribution Account are assumed to be 10.0% of Compensation. Defined Contribution Hybrid Contribution Accounts are assumed to grow prospectively using a 5.24% annual investment return (80% of the net investment return assumption as shown above).
- Basis for demographic assumptions: The post-retirement healthy and disabled mortality assumptions used were based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. Most other demographic assumptions used were based on a 2009 experience study using data as of June 30, 2003, June 30, 2005, and June 30, 2007. Certain demographic assumptions (e.g. termination and retirement) were impacted by the Act 3 pension reforms and were revised based on the new retirement eligibility and expected future experience.

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**7. RETIREMENT PLAN, (Continued)**

- Termination: Withdrawal rates vary by employment category, age, and service.
- Retirement: Rates of retirement vary by employment category, Act, age and years of Creditable Service, and whether the member was eligible to retire as of June 30, 2013 for Act 447, Act 1, and System 2000 members.
- Disability: Rates are based on the six-month elimination period rates in the 1987 Commissioners Group Disability Table, as adjusted. 100% of disabilities occurring while in active service are assumed to be occupational for members covered under Act 127.
- Pre-retirement Mortality: For general employees not covered under Act No. 127, RP-2014 Employee Mortality Rates for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis. For members covered under Act No. 127, RP-2014 Employee Mortality Rates are assumed with blue collar adjustments for males and females adjusted to reflect Mortality Improvement Scale MP-2016 from the 2006 base year and projected forward using MP-2016 on generational basis. As generational tables, they reflect mortality improvements both before and after the measurement date. 100% of deaths while in active service are assumed to be occupational only for members covered under Act No. 127.
- Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.
- Post-retirement Healthy Mortality: Rates which vary by gender are assumed for healthy retirees and beneficiaries based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 92% of the rates from the UP-1994 Mortality Table for Males and 95% of the rates from the UP-1994 Mortality Table for Females, both projected from 1994 to 2010 using Scale AA. These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.
- Post-retirement Disabled Mortality: Rates which vary by gender are assumed for disabled retirees based on a study of plan's experience from 2007 to 2012 and updated expectations regarding future mortality improvement. The 2010 base rates are equal to 105% of the rates from the CIP-1994 Mortality Table for Males and 115% of the rates from the UP-1994 Mortality Table for Females. These base rates are projected using Mortality Improvement Scale MP-2016 on a generational basis. As a generational table, it reflects mortality improvements both before and after the measurement date.

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**7. RETIREMENT PLAN, (Continued)**

- Marriage: 100% of current active members covered under Act 127 who die in service or become disabled are assumed to have qualifying beneficiaries receiving the maximum benefits possible, which are approximated by a spouse with males 4 years older than females.
- Actuarial Cost Method: The plan's actuarial cost method is the entry age normal method.
- Asset Value Method: Market value of assets.
- Inflation Rate: 2.50%

***Illiquid Assets***

The Act No. 32 AUC calculation is based on the objective of maintaining a \$1.0 billion gross asset buffer at all times. It is important to note that a material portion of ERS assets are illiquid in nature. Thus, if the Act No. 32 AUC is not paid in full and the \$1.0 billion buffer is not maintained, the ERS will run into liquidity issues and may be forced to sell illiquid assets, potentially at significant loss to the further detriment of the ERS. As of June 30, 2016, ERS had approximately \$997 million in illiquid assets, comprised primarily of loans to ERS members and the COFINA investment. This projection assumes that these illiquid assets will be converted to liquid assets when needed. The AUC has increased markedly from the initial \$140 million estimate prepared in 2013.

The tax-free municipal bond index of 2.85% as of June 30, 2016, was used as the discount rate in the determination of the Total Pension Liability as of June 30, 2016.

<b>Net Pension Liability</b>	<b>Total</b>	<b>Proportional Share</b>
Total Pension Liability	\$ 36,432,873,000	\$ 31,457,759
Fiduciary Net Position	(1,265,885,000)	(1,093,021)
Net Pension Liability	37,698,758,000	32,550,780
Fiduciary Net Position as a % of Total Pension Liability	-3.47%	-3.47%
Covered Payroll	3,344,382,000	2,887,668
Net Pension Liability as a % of Covered Payroll	1127.23%	1127.23%

***Discount Rate***

The ERS's fiduciary net position was not projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the discount rate for calculating the total pension liability is equal to the single equivalent rate that result in the same actuarial present value as the long-term expected rate of return applied to benefit payments, to the extent that the ERS's fiduciary net position is projected to be sufficient to make projected benefit payments, and the municipal bond rate applied to benefit payments, to the extent that the ERS's fiduciary net position is not projected to be sufficient. (Refer to Puerto Rico Government Employees Retirements System, June 30, 2016 Actuarial Valuation Report.)

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**7. RETIREMENT PLAN, (Continued)**

***Discount Rate, (Continued)***

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

	<b>June 30, 2015</b>	<b>June 30, 2016</b>
Discount Rate	3.80%	2.85%
Long-term Expected Rate of Return Net of Investment Expense	6.55%	6.55%
Municipal Bond Rate*	3.80%	2.85%

\* Bond Buyer General Obligation 20-Bond Municipal Bond Index

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

***Sensitivity of OMEP Proportionate Share of The Net Pension Asset to Changes in The Discount Rate***

The following presents OMEP's proportionate share of the net pension asset calculated using the discount rate of 2.85 percentage, as well as what OMEP's proportionate share of the net pension asset or net pension liability would be if it were calculated using a discount rate that is one percentage lower (1.85 percent) or one percentage point higher (3.85 percent) than the current rate:

	At 1 Percent Decrease (1.85%)	At Current Discount Rate (2.85%)	At 1 Percent Increase (3.85%)
Net Pension Liability	\$ 37,334,459	\$ 32,550,780	\$ 28,655,897

***Fiscal Plan for Puerto Rico***

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

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

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

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**7. RETIREMENT PLAN, (Continued)**

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

Operating a retirement system on a “pay-go” charge basis may be conceptually simple but can be very difficult in practice when the plan sponsor’s current funds and ability to rely on reserves are limited. While the valuation of ERS liabilities for financial reporting purposes is conducted on an annual basis in arrears, statutory contributions and benefit payments vary continuously and respond instantaneously to emerging events.

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

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

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

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

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

The financial statements and required supplementary information for the ERS is available by writing to Administrator-Employees' Retirement system of the Commonwealth of Puerto Rico, PO Box 42003, Minillas Station, Santurce, PR 00940.

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**8. GOING CONCERN**

The discussion in the following paragraphs regarding the OMEP financial and liquidity risks provides the necessary background and support for management's evaluation as to whether there is substantial doubt about the OMEP ability to continue as a going concern for 12 months beyond the date of the financial statements or for an extended period if there is currently known information that may raise substantial doubt shortly thereafter. GASB Statement No. 56, Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statement on Auditing Standards, establishes that the continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary.

Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Indicators such as negative trends in operating losses and negative cash flows, possible financial difficulties such as nonpayment or default or debt and/or restructurings or noncompliance with capital or reserve requirement, and internal or external matters impacting the governmental entity's ability to meet its obligations as they become due, are factors that area considered in this evaluation. The OMEP faces significant risks and uncertainties, including liquidity risk, which is the risk of not having sufficient liquid financial resources to meet future obligations when they come due. These circumstances together with other factors further described below, have led management to conclude that doubts could exist as to the ability of the OMEP to continue operations as usual if they do not make significant operational and programmatic adjustments, which would be necessary to avoid a financial distress that would impair the ability of the OMEP to continue as a going concern. This statement is required to comply with GASB Statement No. 56.

OMEP has had significant recurring operating losses and it is highly dependent on the Commonwealth appropriations to finance its operations. Approximately 97.7% of the OMEP's total revenues are derived from the Commonwealth appropriations which amounted to approximately \$39.3 million for the year ended June 30, 2017. Moreover, the OMEP has limited ability to raise operating revenues due to the economic and political challenges of Puerto Rico. OMEP ability to continue receiving similar operational support and financing from the Commonwealth is uncertain.

The Commonwealth's recurring deficits, negative financial position, further deterioration of its economic condition, and inability to access the credit markets raise substantial doubt about the Commonwealth's ability to continue as a going concern. The significant financial difficulties being experienced by the Commonwealth is likely to have a significant adverse impact on the OMEP, given its reliance on Commonwealth appropriations.

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**9. CHANGE IN ACCOUNTING PRINCIPLES/RESTATEMENT**

OMEF implemented the Governmental Accounting Standards Board (GASB) Statement No. 68, Accounting and Financial Reporting for Pensions, - an amendment of GASB Statement No. 27 and GASB Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68, in the fiscal year ended June 30, 2017. The implementation of the statement required OMEF to allocate its proportionate share of the local Government Employees' Retirement System net pension liability, deferred outflows of resources, deferred inflows of resources, pension expense and the effects on the net position of contributions made by OMEF during the measurement period.

To adjust Net Position Proportioned Share beginning balance of July 1, 2016 to the audited amount as of June 30, 2016 of Puerto Rico Employee Retirement System Administration, the Beginning Net Position was adjusted by \$18,802,081. The management of OMEF believes that this adoption presents more appropriately the financial position of OMEF in line with the requirements established by the adopted Statements. Also, adjustment to Net Position were made to reflect the effects of the proportioned share of net pension liability.

Accordingly, the beginning net position balance was restated as follows:

Beginning Net Position, as Previously Reported June 30, 2016	\$ 7,943,304
Deferred Outflows - Measurement date as of June 30, 2016	2,535,867
Net Pension Liability - Measurement date as of June 30, 2016	(20,371,788)
Deferred Inflows - Measurement date as of June 30, 2016	<u>(966,160)</u>
Total Prior Period Adjustment	<u>(18,802,081)</u>
Beginning Net Position (Deficit), as Restated, July 1, 2016	<u><u>\$ (10,858,777)</u></u>

**10. SUBSEQUENT EVENTS**

On August 23, 2017, the Legislature Enacted Act No. 106 to establish the "Law to Guarantee the Payment to Our Pensioners and Establish a New Plan of Defined Contributions for Public Servants", for the purpose of reforming the Retirement System of the Employees of the Government of Puerto Rico and the Retirement System for Teachers , in accordance with the economic and fiscal reality of Puerto Rico and the provisions of the Fiscal Plan for Puerto Rico, certified according to the provisions of Public Law 114-187, known as Puerto Rico Oversight, Management, and Economic Stability Act, or "PROMESA", for its acronym in English; to establish that the General Fund, through the "pay as you go" system, assumes the payments that the Retirement System of the Employees of the Government of Puerto Rico, the Retirement System for Teachers and the Retirement System for the Judicature do not can perform; to arrange for the three Retirement Systems to continue to fulfill their obligations towards their beneficiaries and pensioners by providing the General Fund with their available funds and funds from the liquidations of their assets; establish the New Defined Contribution Plan and

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**10. SUBSEQUENT EVENTS, (Continued)**

provide for its administration; create the Retirement Board, delegate faculties and duties; amend Section 2 of Act No. 12 of October 19, 1954, as amended, known as the "Judiciary Withdrawal Act"; to amend Sections 1-1.04 and 4-101, to repeal Sections 11 and 12 and to renumber Sections 13, 14 and 15 as Sections 11, 12 and 13, respectively, of Section 4-103 of Act No. 447 of May 15 of 1951, as amended, known as the "Retirement System for Employees of the Government of the Commonwealth of Puerto Rico Act"; amend Articles 1.1, 2.3 and repeal Sections 2.4, 2.5 and 2.6 of Act 160-2013, as amended, known as the "Retirement System Act for Teachers of the Commonwealth of Puerto Rico"; amend Section 1081.01 of Act 1-2011, as amended, known as the "Internal Revenue Code for a New Puerto Rico"; to repeal Act 211-2015, as amended, known as the "Voluntary Grant Program Act", to guarantee the benefits to the Prerequisites and to provide for employees who have requested such benefits to complete the process; to authorize the Financial Advisory Authority and Fiscal Agency of Puerto Rico to design, implement and supervise an incentive separation program for the public service of the employees of the Executive Branch; and for other related purposes. It is declared as public policy of the Government of Puerto Rico the protection of the pensions of all retirees of the public service who were Participants in the three Retirement Systems mentioned above. Therefore, as of July 1, 2017, pursuant to the Joint Resolution of Chamber No. 188 of 2017, as certified by the Fiscal Supervision Board on July 13, 2017, the Government of Puerto Rico became the direct payer of the pensions of our retirees. Given the weight that this implies on the General Fund, which is estimated at billions of dollars a year, the employer's contributions to the three Retirement Systems were eliminated, as well as the Additional Uniform Contribution, according to the provisions of the Joint Resolutions No. Chamber. 186, 187 and 188 of 2017. Retirement Systems must provide their available funds and the net proceeds from the liquidation of its assets to the General Fund to help pay the Accrued Pension, excepting the headquarters building of the Retirement System for Teachers, known as the Capital Center Building, North Tower, located in Hato Rey, Puerto Rico, which will not have to be settled. Once Retirement Systems exhaust their assets, account for the payment of accrued pensions, which will draw heavily on the General Fund, as provided in this Act, shall assume and guarantee the payment of accrued pension as established in this Act. However, the municipalities, the Legislative Branch, public corporations, the government and the administration of the courts are obliged to pay the fee "pay-Go" as appropriate for each to nourish the account for payment of the Accumulated Pensions.

Likewise, it is declared as public policy to protect the future of our public servants. Through this Act we ensure that they can have a dignified retirement, free of uncertainty, segregating their personal contributions, guaranteeing them and setting a new defined contribution plan, trust or similar instrument that will enable them to protect and guarantee their contributions to separate accounts.

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



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Notes to Financial Statements

June 30, 2017

**9. SUBSEQUENT EVENTS (Continued)**

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

On September 20, 2017, Hurricane Irma and Maria directly hit Puerto Rico, severely affecting the island's infrastructure. OMEP evaluate the physical damages to the school regions and districts offices assets, including construction, vegetative material removal and subcontractor for construction and vegetative material removal. The total claim made to FEMA for Irma amounted to approximately 3.1 million and for Maria amounted to approximately 29.2 million. The ultimate resolution of these claims still pending OMEP believes that the amount estimated are adequate and the method used for making such estimate are also adequate.

OMEP evaluated its subsequent events until June 28, 2019, date on which the financial statements were ready for issuance. OMEP's management understands that no material events occurred subsequent to June 30, 2017, that requires being recorded or required additional disclosures in the financial statements.

**REQUIRED SUPPLEMENTARY INFORMATION**  
(See Independent Auditors' Report)

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Combining Balance Sheet

For the Year Ended June 30, 2017

**ASSETS**

		<b><u>Capital Project Funds</u></b>		
	Other Special Revenue	\$29 M Project	Total Capital Projects	Total Other Funds
Assets:				
Cash	\$ 5,413	\$ -	\$ -	\$ 5,413
	<u>\$ 5,413</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,413</u>

**LIABILITIES AND FUND BALANCES**

Liabilities:				
Accounts Payable	\$ 51,878	\$ 11,036	\$ 11,036	\$ 62,914
Due to General Fund	298,820	-	-	298,820
	<u>350,698</u>	<u>11,036</u>	<u>11,036</u>	<u>361,734</u>
Total Liabilities				
Fund Balance:				
Committed	-	-	-	-
Unassigned	(345,285)	(11,036)	(11,036)	(356,321)
	<u>(345,285)</u>	<u>(11,036)</u>	<u>(11,036)</u>	<u>(356,321)</u>
Total Fund Balance				
	<u>(345,285)</u>	<u>(11,036)</u>	<u>(11,036)</u>	<u>(356,321)</u>
Total Liabilities and Fund Balance	<u>\$ 5,413</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 5,413</u>

**OFFICE FOR THE IMPROVEMENTS  
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Combining Statement of Revenues, Expenditures  
and Changes in Fund Balances

For the Year Ended June 30, 2017

	<b>Capital Project Funds</b>			
	Other Special Revenue	\$29 M Project	Total Capital Projects	Total Other Funds
<b><u>REVENUES</u></b>				
Other Income	\$ -	\$ 13,762	\$ 13,762	\$ 13,762
Total Revenues	-	13,762	13,762	13,762
<b><u>EXPENDITURES</u></b>				
Current:				
Maintenance, Construction and Improvement of Public Schools	8,349	-	-	8,349
Total Expenditures	8,349	-	-	8,349
Excess of Revenues Over Expenditures	(8,349)	13,762	13,762	5,413
Other Financing (Uses):				
Transfer In	15,481	-	-	15,481
Transfer Out	(129,228)	-	-	(129,228)
	(113,747)	-	-	(113,747)
Net Change in Fund Balances	(122,096)	13,762	13,762	(108,334)
Fund Balance at Beginning of Year	(352,417)	104,430	104,430	(247,987)
Fund Balance at End of Year	\$ (474,513)	\$ 118,192	\$ 118,192	\$ (356,321)

**OFFICE FOR THE IMPROVEMENTS  
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Statement of Revenues and Expenditures  
Budgetary Comparison Schedule-General Fund

June 30, 2017

	<b>Original Budget</b>	<b>Final Budget</b>	<b>Actual</b>	<b>Variance</b>
<b>Revenues:</b>				
State Services	\$ 16,010,000	\$ 16,010,000	\$ 16,010,000	\$ -
Appropriations from PBA	-	-	75,614	75,614
Appropriations from PRDE	-	-	23,336,559	23,336,559
Other Income and Interest	-	-	6,947	6,947
<b>Total Revenues</b>	<b>16,010,000</b>	<b>16,010,000</b>	<b>39,429,120</b>	<b>23,419,120</b>
<b>Expenditures:</b>				
Payroll and Related	7,655,000	7,655,000	6,766,926	(888,074)
Payments for Public Facilities and Services Maintenance, Construction and Improvement of Public Schools	381,000	289,000	345,697	56,697
Transportation and Subsistence Expenses	5,813,000	6,600,000	24,406,432	17,806,432
Professional Services	269,000	192,000	454,538	262,538
Materials and Supplies	445,000	445,000	728,427	283,427
Purchase of Equipment	896,000	558,500	585,256	26,756
Advertising and Announcements	544,000	267,000	214,518	(52,482)
	7,000	3,500	-	(3,500)
<b>Total Expenditures</b>	<b>16,010,000</b>	<b>16,010,000</b>	<b>33,501,794</b>	<b>17,491,794</b>
<b>Excess of Expenditures Over Revenues</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 5,927,326</b>	<b>\$ 5,927,326</b>

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Schedule of Statutorily Required Employer Contributions Pension Plan

June 30, 2017

	(a)	(b)	(a)-(b)	(c)	(b/c)
Year Ended June 30,	Statutorily Required Contribution	Contributions in Relation to Statutorily Required Contributions	Contribution Deficiency (Excess)	Authority's Covered Payroll	Contributions as Percent of Covered Payroll
2017	\$ 614,650	\$ 614,650	-	\$ 288,768	21.28%

Fiscal year 2017 was the first year that the new requirements of GASB 68 were implemented at OMEP. This schedule is required to illustrate 10-years of information. However, until a 10-year trend has been completed, information is presented only for the years for which the required supplementary information is available.

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Schedule of Proportionate Share of the Collective Net Pension Liability

June 30, 2017

	(a)	(b)	(a)-(b)	(b/c)	Plan Fiduciary
<b>Year Ended June 30,</b>	<b>Corporation's Proportion of the Net Pension Liability</b>	<b>Corporation's Proportionate Share of the Net Pension Liability</b>	<b>Corporation's Covered Payroll</b>	<b>Corporation's Proportionate Share of the Net Pension Liability as of Percentage of its Covered Payroll</b>	<b>Net Position (Deficit) as a Percentage of Total Pension Liability</b>
2017	0.08634%	\$ 32,550,780	\$ 2,887,688	1127.23%	-3.47%

Fiscal year 2017 was the first year that the new requirements of GASB 68 were implemented at OMEP. This schedule is required to illustrate 10-years of information. However, until a 10-year trend has been completed, information is presented only for the years for which the required supplementary information is available.

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Note to Required Supplementary Information

For the Year Ended June 30, 2017

**1. BUDGET PROCESS AND BUDGETARY BASIS OF ACCOUNTING**

OMEPS budget is prepared for Governmental Fund following state requirements. Budget amendments are approved by the Board of Directors. The budget is prepared on a budgetary (statutory) basis of accounting, which is different from GAAP. Revenues include amounts classified by GAAP as other financing sources and expenditures include encumbrances and amounts classified by GAAP as other financing uses. On a GAAP basis, encumbrances outstanding at year end are reported in the governmental funds statements as a reservation of fund balance since they do not constitute expenditures or liabilities while on a budgetary basis encumbrance are recorded as expenditures of current year.

The presentation of the budgetary data excludes long-term obligations such as compensated absents and depreciation charges for capital assets. Historically, those obligations have been budgeted on a "pay as you go" basis. The budgetary comparison schedule presents comparisons of the original and final legally adopted budget with actual data on a budgetary basis.

**2. EMPLOYEES' RETIREMENT SYSTEM (ERS)**

Basis of Presentation

The amounts presented in the Schedules were prepared in accordance with U.S. generally accepted accounting principles. The numbers were derived from a report issued by KPMG dated November 2, 2018. The full report is available by the Employees' Retirement System. Such preparation requires management of ERS to make a number of estimates and assumptions relating to the reported amounts. Due to the inherent nature of these estimates, actual results could differ from those estimates.





*De Angel & Compañía*  
COMPAÑÍA DE RESPONSABILIDAD LIMITADA  
CONTADORES PÚBLICOS AUTORIZADOS

PO Box 5460  
Caguas, Puerto Rico 00726-5460

Glasgow 1890 College Park IV  
San Juan, Puerto Rico 00921-4813  
[www.deangel.com](http://www.deangel.com)  
(787) 758-4428 • Fax 763-9386

June 28, 2019

To Mr. Eligio Hernández Pérez  
**Office for the Improvements of  
Public Schools**  
San Juan, Puerto Rico

The stockholders and staff of De Angel & Compañía, CPA, LLC, are pleased to announce the successful completion of an independent peer review of our accounting and auditing practice. This review was undertaken as a condition of membership in the American Institute of Certified Public Accountants (AICPA), the national organization of CPAs in public practice, industry, government and education.

In 1988, the members of the AICPA overwhelmingly approved a proposal to require members in public practice to participate in a practice-monitoring program. With the adoption of this proposal, the AICPA implemented a peer review program of unprecedented scope in the CPA profession or any other. Our participation in peer review demonstrates our firm's desire to measure up to the profession's high standards of professionalism and our commitment to maintaining and improving the quality of our practice.

In August 2000, the Puerto Rico Society of CPAs (PRSCPA) adopted a voluntary peer review program, which follows the lead established by the AICPA.

Our peer review was conducted by **Roman Toro & Co., CPA, PSC**, an independent firm (the Reviewer). The Reviewer first determined that we have an adequate quality control system, and then checked to see that professional's standards were followed in a representative sample of our accounting and auditing engagements.

After thorough study of our policies and procedures, the Reviewer concluded our firm complies with the stringent quality control standards established by the AICPA and the PRSCPA. Our firm is committed to periodic peer review to foster quality performance.

Bankers, bonding agents, investors, suppliers, legal advisors and others use the financial statements our firm audits, reviews, or compiles. We think those people, our clients, and our own staff deserve independent quality assurance that our firm provides quality services. We are proud of our peer review results and would be happy to answer any questions you might have.

Sincerely,

Carlos De Ángel Ramírez  
President

## **Report on the Firm's System of Quality Control**

January 28, 2019

To the Partners of De Angel & Compañía, CPA, LLC  
and the Peer Review Committee of the Puerto Rico Society of CPAs.

We have reviewed the system of quality control for the accounting and auditing practice of De Angel & Compañía, CPA, LLC (the firm) in effect for the year ended April 30, 2018. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Review established by Peer Review Board of the American Institute of Certified Public Accountants (Standards).

A summary of the nature, objectives, scope, limitations of, and the procedures performed in a System Review as described in the Standards may be found at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary). The summary also includes an explanation of how engagements identified as not performed or reported in conformity with applicable professional standards, if any, are evaluated by a peer reviewer to determine a peer review rating.

### **Firm's Responsibility**

The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. The firm is also responsible for evaluating actions to promptly remediate engagements deemed as not performed or reported in conformity with professional standards, when appropriate, and for remediating weaknesses in its system of quality control, if any.

### **Peer Reviewer's Responsibility**

Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review.

## Required Selections and Considerations

Engagements selected for review included engagements performed under *Government Auditing Standards*, including compliance audits under the Single Audit, and an audit of an employee benefit plan.

As a part of our peer review, we considered reviews by regulatory entities as communicated by the firm, if applicable, in determining the nature and extent of our procedures.

## Opinion

In our opinion, the system of quality control for the accounting and auditing practice of De Angel & Compañía, CPA, LLC, in effect for the year ended April 30, 2018 has been suitable designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firm can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. De Angel & Compañía, CPA, LLC, has received a peer review rating of pass.



ROMAN TORO & CO., CPA, P.S.C.  
LICENSE #35 - IN FORCE  
Expires December 1, 2020

Stamp Number E358129 was  
affixed to the original of this report