



Puerto Rico Tourism Company
Slot Machines Operations
(A Proprietary Fund of the Puerto Rico Tourism Company)

Basic Financial Statements and
Required Supplementary Information
Fiscal Year Ended June 30, 2016



**PUERTO RICO TOURISM COMPANY
SLOT MACHINES OPERATIONS**
(A Proprietary Fund of the Puerto Rico Tourism Company)

Basic Financial Statements and Required Supplementary Information
Fiscal Year Ended June 30, 2016

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INDEPENDENT AUDITORS' REPORT

To: The Board of Directors
Puerto Rico Tourism Company:

We have audited the accompanying financial statements of the Puerto Rico Tourism Company Slot Machines Operations, a proprietary fund of the Puerto Rico Tourism Company, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Puerto Rico Tourism Company Slot Machines Operations 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 qualified audit opinion.



Basis for Qualified Opinion

The Puerto Rico Tourism Company Slot Machines Operations' full time employees participate in a cost-sharing defined benefit program, which is administered by the Employees' Retirement System of the Commonwealth of Puerto Rico, a Statutory Trust and component unit of the Commonwealth of Puerto Rico. The Puerto Rico Tourism Company Slot Machines Operations was required to adopt Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment to 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*, that were effective for fiscal years beginning after June 15, 2014. However, the adoption of GASB Statements No. 68 and 71 requires the Puerto Rico Tourism Company Slot Machines Operations to obtain, from the Employees' Retirement System of the Commonwealth of Puerto Rico, technical information regarding actuarial valuations, discount rates, the Puerto Rico Tourism Company Slot Machines Operations' proportionate share of the net pension liability, and deferred outflows and inflows of resources related to pension costs.

As of June 30, 2016, the Employees' Retirement System of the Commonwealth of Puerto Rico did not provide the required information described above, therefore, the Puerto Rico Tourism Company was unable to adopt the requirements of GASB Statements No. 68 and 71. Consequently, the accompanying financial statements do not contain any adjustments that may be necessary, neither the disclosures and supplementary information required by GASB Statements No. 68 and 71.

Qualified Opinion

In our opinion, except for the possible 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 financial position of the Puerto Rico Tourism Company Slot Machines Operations as of June 30, 2016, and the changes in financial position, and its cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 9 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.

San Juan, Puerto Rico
December 12, 2016.

Stamp No. E259405 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

PUERTO RICO TOURISM COMPANY

SLOT MACHINES OPERATIONS

(A Proprietary Fund of the Puerto Rico Tourism Company)

Management Discussion & Analysis (Unaudited)

Fiscal Year Ended June 30, 2016

As management of the Puerto Rico Tourism Company (the Company) Slot Machines Operations (the Slot Machines Operations), we offer readers of these basic financial statements our discussion and analysis of the Slot Machines Operations' financial performance during the fiscal year that ended on June 30, 2016. Please read the information presented in this section together with the Slot Machines Operations' basic financial statements, including the notes thereto, which follow this section.

This discussion and analysis is intended to serve as an introduction to the Slot Machines Operations' basic financial statements, which comprise the following components: (1) statement of net position; (2) statement of revenues, expenses, and changes in net position; (3) statement of cash flows; and (4) notes to basic financial statements.

Financial Highlights

- The Slot Machines Operations experienced a decrease in net operating revenues of approximately \$2.0 million, as a result of the closing of local hostelry casinos and a reduction of the hourly operation in various casinos.
- The Slot Machines Operations total operating expenses increased by approximately \$585 thousand. This was the result of a contract with the operator of the linked slot machines.
- The distributions made to the Commonwealth of Puerto Rico (the Commonwealth) and the University of Puerto Rico when aggregated to the transfers made to the general fund of the Company during fiscal year ended June 30, 2016, amounted to approximately \$137.2 million, which represents a decrease of approximately \$2.5 million, when compared to fiscal year ended June 30, 2015.
- The Slot Machines Operations is required to adopt the provisions of 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. These Statements were effective for fiscal years beginning after June 15, 2014.

The adoption of GASB Statements 68 and 71 requires Slot Machines Operations to obtain from the Employees' retirement System of the Commonwealth of Puerto Rico, a Statutory Trust and Component Unit of the Commonwealth of Puerto Rico, technical information regarding actuarial valuations, discount rates, Slot Machines Operations' proportionate share of the net pension liability and deferred outflows and inflows of resources related to pension costs. Since June 30, 2015, and in spite of several formal requests from Slot Machines Operations' management, the Employees' Retirement System of the Commonwealth of Puerto Rico did not provide Slot Machines Operations with the required audited information. The impact of these Statements in the Slot Machines Operations' financial statements could not be determined. As a result, Slot Machines Operations' financial position and results of operations for the year ended June 30, 2016 could be different. Slot Machines Operations' management expects to receive this information during the first and second quarter of the fiscal year ending June 30, 2017.

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- The Company continues to be impacted by the actual fiscal deterioration of the economic condition of the Commonwealth of Puerto Rico. As publicly disclosed, the Commonwealth of Puerto Rico is facing a severe fiscal, economic and liquidity crisis, further deterioration of its economic condition, and inability to access the credit market. There has been a prolonged economic recession since year 2006, high unemployment, population decline and high level of debt and pension obligations.

Overview of the Financial Statements

The basic financial statements of the Slot Machines Operations are prepared in conformity with accounting principles generally accepted in the United States of America, as applicable to governmental entities. The Slot Machines Operations is a business-type activity of the Company and, as such, is included as a proprietary fund in the Company's basic financial statements. It follows the requirements of proprietary fund reporting, which uses the economic resources measurement focus and the accrual basis of accounting to prepare the basic financial statements.

The statement of net position includes all of the entity's assets and liabilities. Net position is composed of three categories: net investment in capital assets, restricted, or unrestricted. All of the current year's revenues and expenses are accounted for in the statement of revenues, expenses, and changes in net position, regardless of when cash is received or paid. All changes in net position are reported as soon as the underlying event gives rise to the change that occurs, regardless of the timing of the related cash flows.

The notes to the basic financial statements provide additional information that is essential for a full understanding of the data provided in the basic financial statements. The notes are an integral part of the basic financial statements.

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Financial Analysis

Condensed financial information on the Puerto Rico Tourism Company Slot Machines Operations' statement of net position as of June 30, 2016 and 2015 is as follows:

	<u>As of June 30</u>		<u>Increase (decrease)</u>	<u>Variance percentage</u>
	<u>2016</u>	<u>2015</u>		
Assets:				
Current assets	\$ 22,684,137	\$ 22,691,976	\$ (7,839)	0%
Capital assets	31,816	12,383	19,433	157%
Total assets	<u>\$ 22,715,953</u>	<u>\$ 22,704,359</u>	<u>\$ 11,594</u>	<u>157%</u>
Liabilities:				
Current liabilities	\$ 20,922,842	\$ 20,850,600	\$ 72,242	0%
Noncurrent liabilities	1,793,111	1,853,759	(60,648)	-3%
Total liabilities	<u>\$ 22,715,953</u>	<u>\$ 22,704,359</u>	<u>\$ 11,594</u>	<u>-3%</u>
Net position:				
Net investment in capital assets	\$ 31,816	\$ 12,383	\$ 19,433	157%
Unrestricted (deficit)	(31,816)	(12,383)	(19,433)	157%
Total net position	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0%</u>

Slot Machines Operations Fund's assets at June 30, 2016, consist substantially of accounts receivable of approximately \$778 thousand, and due from the Company's general fund of approximately \$21.9 million. Total liabilities consist of unremitted distributions to the Commonwealth, the University of Puerto Rico and Participants of Slot Machines Operations of approximately \$1.7 million, \$5.2 million and \$11.5 million, respectively, accrued compensated absences of approximately \$2.8 million and accrued Christmas bonus of approximately \$125 thousand.

Accounts receivable decreased by approximately \$651 thousand, from approximately \$1.4 million to approximately \$779, due to Slot Machines Operations transfer to the general fund to pay June's distributions to the Commonwealth of Puerto Rico, the University of Puerto Rico and Participants of Slot Machines Operations.

Due from the Company's general fund increased by approximately \$644 thousand, from approximately \$21.3 million to approximately \$21.9 million.

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Condensed financial information on the Slot Machines Operations' revenues, expenses, and changes in net position for the years ended June 30, 2016 and 2015 is presented below:

	<u>Year ended June 30</u>		<u>Increase (decrease)</u>	<u>Variance percentage</u>
	<u>2016</u>	<u>2015</u>		
Net operating revenues	\$ 152,525,392	\$ 154,479,479	\$ (1,954,087)	-1%
Operating expenses:				
Payroll and related payroll benefits	9,338,650	9,727,896	(389,246)	-4%
Depreciation and amortization	29,056	20,024	9,032	45%
Rent	2,373,752	201,335	2,172,417	1079%
Other	3,554,218	4,761,157	(1,206,939)	-25%
Total operating expenses	<u>15,295,676</u>	<u>14,710,412</u>	<u>585,264</u>	<u>4%</u>
Operating income	<u>137,229,716</u>	<u>139,769,067</u>	<u>(2,539,351)</u>	<u>-2%</u>
Nonoperating expenses:				
Distributions to:				
Commonwealth of Puerto Rico	20,790,302	21,175,282	(384,980)	-2%
University of Puerto Rico	62,370,906	63,524,076	(1,153,170)	-2%
Transfers to the Puerto Rico Tourism Company's general fund	<u>54,068,508</u>	<u>55,069,709</u>	<u>(1,001,201)</u>	<u>-2%</u>
Total distributions and transfers	<u>137,229,716</u>	<u>139,769,067</u>	<u>(2,539,351)</u>	<u>-2%</u>
Change in net position	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>0%</u>

Total operating revenues decreased by approximately \$2.0 million, from approximately \$154.5 million to approximately \$152.5 million as a result of the closing of local hostelry casinos and a reduction of the hourly operation in various casinos. This trend has been consistent for the past eight years.

Total operating expenses increased by approximately \$585 thousand during the year ended June 30, 2016. This was the result of a contract with the operator of the linked slot machines. Total non-operating expenses (distributions to the Commonwealth of Puerto Rico and the University of Puerto Rico) decreased by approximately \$1.5 million, from approximately \$84.7 million to approximately \$83.1 million as a result of the decrease in operating revenues.

Interfund transfers to the General Fund decreased by approximately \$1 million, from approximately \$55.1 million to approximately \$54.1 million directly related to the reduction in net operating revenues.

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The Slot Machines Operations' basic financial statements do not present net position since, as provided by Act No. 221 of 1948, as amended and corresponding regulations, net proceeds are all distributed to the Slot Machines Operations' participants, the Commonwealth, the University of Puerto Rico and the Company, at the end of each month.

Capital Assets

As of June 30, 2016, capital assets amounted to approximately \$32 thousand, net of accumulated depreciation, when compared to approximately \$12 thousand as of June 30, 2015.

See note 4 to the basic financial statements for additional details and activity of capital assets as of and during the fiscal year ended June 30, 2016.

Long-Term Debt

Long-term debt in the Slot Machines Operations amounted to approximately \$1.8 million and approximately \$1.2 million as of June 30, 2016 and 2015, respectively. Long-term debt as of June 30, 2016 consisted of accrued compensated absences and Christmas bonus.

See note 5 to the basic financial statements for additional analysis and activity of long-term debt of the Slot Machines Operations during the fiscal year ended June 30, 2016.

Economic Factors

During fiscal year ended June 30, 2016, the number of persons registered in lodgings endorsed by the Company, including residents of Puerto Rico and outer tourists, was approximately 2.64 million, an increase of 1.9% over the number of persons registered during the same period of fiscal year ended June 30, 2015. The average occupancy rate in these lodgings during fiscal year ended June 30, 2016 was 70.4%, a minimal increase of 0.6% from the prior fiscal year. Also, during fiscal year ended June 30, 2016, the average number of rooms available in lodgings endorsed by the Company increased by approximately 1.4% to 14,844 rooms compared to the same period of fiscal year ended June 30, 2015.

According to a payroll survey, employment in the leisure and hospitality sector was approximately 82,300 for fiscal year ended June 30, 2016, an increase of 1.2% over employment for fiscal year ended June 30, 2015 that its final employment numbers was 81,300. These figures imply stabilization on the labor productivity of this sector during fiscal year ended June 30, 2016.

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The City of San Juan, Puerto Rico is the largest homeport for cruise ships in the Caribbean and one of the largest homeports for cruise ships in the world. The following tables present a summary of tourism data segregated by number of visitors and their expenditures during the last five years:

	Tourism Data⁽¹⁾			
	Number of Visitors			
	Tourist Hotels⁽²⁾	Excursionists⁽³⁾	Other⁽⁴⁾	Total
Fiscal year ended June 30:				
2011	1,408,536	1,165,758	1,539,931	4,114,225
2012	1,507,984	1,127,842	1,561,103	4,196,929
2013	1,586,100	1,038,000	1,613,600	4,237,700
2014	1,634,800	1,209,700	1,611,200	4,455,700
2015	1,737,200	1,509,300	1,804,500	5,051,000

	Total Visitors' Expenditures			
	(In millions)			
	Tourist Hotels⁽²⁾	Excursionists⁽³⁾	Other⁽⁴⁾	Total
Fiscal year ended June 30:				
2011	\$ 1,618.9	\$ 169.3	\$ 1,354.6	\$ 3,142.8
2012	\$ 1,706.9	\$ 167.7	\$ 1,318.3	\$ 3,192.9
2013	\$ 1,811.8	\$ 156.0	\$ 1,365.8	\$ 3,333.6
2014	\$ 1,874.0	\$ 182.3	\$ 1,382.3	\$ 3,438.6
2015	\$ 2,048.0	\$ 227.8	\$ 1,549.5	\$ 3,825.3

(1) Only includes information about non-resident tourists registering in tourist hotels. They are counted once even if registered in more than one hotel.

(2) Includes visitors in guesthouses

(3) Includes cruise ship visitors and transient military personnel

(4) Includes visitors in homes of relatives, friends, and in hotel apartments

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Subsequent Events

Refer to Note 11 of the accompanying basic financial statements for a description of subsequent events.

Request for Information

This financial report is designed to provide a general overview of the Slot Machine Operations for all those with an interest in the Slot Machines Operation's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Office of the Finance Director, Puerto Rico Tourism Company, Tanca Street #500, Ochoa Building 3rd Floor, Old San Juan, San Juan, PR, 00902-3960.

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Statement of Net Position

June 30, 2016

ASSETS:

Current assets:

Accounts receivable from Slot Machines Operations' participants	\$ 778,523
Due from the Puerto Rico Tourism Company's general fund	<u>21,905,614</u>
Total current assets	22,684,137

Non-current assets - capital assets, net

31,816

Total assets

22,715,953

LIABILITIES:

Current liabilities:

Unremitted distributions to:

Commonwealth of Puerto Rico	1,726,282
University of Puerto Rico	5,192,532
Participants of Slot Machines Operations	11,518,076
Accounts payable	1,181,024
Due to Commonwealth of Puerto Rico	163,946
Accrued compensated absences	1,015,444
Christmas bonus	<u>125,538</u>

Total current liabilities

20,922,842

Noncurrent liabilities – accrued compensated absences

1,793,111

Total liabilities

22,715,953

NET POSITION:

Net investment in capital assets 31,816

Unrestricted deficit (31,816)

\$ —

See accompanying notes to basic financial statements.



**PUERTO RICO TOURISM COMPANY
SLOT MACHINES OPERATIONS**

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Statement of Revenues, Expenses, and Changes in Net Position

Fiscal Year Ended June 30, 2016

OPERATING REVENUES:

Revenues, net of distributions to Slot Machines Operations' participants of \$128,412,025	<u>\$ 152,525,392</u>
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OPERATING EXPENSES:

Payroll and related payroll benefits	9,338,650
Depreciation and amortization	29,056
Rent	2,373,752
Other	<u>3,554,218</u>

Total operating expenses	<u>15,295,676</u>
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OPERATING INCOME

137,229,716

NONOPERATING EXPENSES:

Distributions to :	
Commonwealth of Puerto Rico	(20,790,302)
University of Puerto Rico	<u>(62,370,906)</u>

Total nonoperating expenses	<u>(83,161,208)</u>
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INCOME BEFORE TRANSFERS

54,068,508

TRANSFERS:

Puerto Rico Tourism Company's general fund	<u>(54,068,508)</u>
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CHANGE IN NET POSITION

—

NET POSITION – Beginning of Year

—

NET POSITION – End of Year

<u>\$</u>	<u>—</u>
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See accompanying notes to basic financial statements.

PUERTO RICO TOURISM COMPANY
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Statement of Cash Flows

Fiscal Year Ended June 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from slot machines	\$ 281,589,227
Cash paid to other participants of Slot Machines Operations	(128,647,474)
Cash paid for payroll and related benefits	(9,414,461)
Cash paid for other operating expenses	<u>(5,279,167)</u>
Net cash provided by operating activities	<u>138,248,125</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:

Distributions to:	
Commonwealth of Puerto Rico	(20,921,790)
University of Puerto Rico	(62,613,653)
Transfers to other funds	
Puerto Rico Tourism Company's General Fund	<u>(54,711,504)</u>
Net cash used in noncapital and related financing activities	<u>(138,246,947)</u>

CASH FLOWS USED IN CAPITAL AND RELATED FINANCING ACTIVITIES:

Cash paid for acquisition of capital assets	<u>(1,178)</u>
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NET CHANGE IN CASH

—

CASH – Beginning of Year

—

CASH – End of Year

\$ —

**RECONCILIATION OF OPERATING INCOME TO
NET CASH PROVIDED BY OPERATING ACTIVITIES:**

Operating income	\$ 137,229,716
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	29,056
Changes in operating assets and liabilities:	
Decrease in accounts receivable	651,810
Decrease in unremitted distributions to participants of Slot Machines Operations	(235,449)
Increase in accounts payable	648,804
Decrease in accrued compensated absences and Christmas bonus	<u>(75,812)</u>
Net cash provided by operating activities	<u>\$ 138,248,125</u>

SUMMARY SCHEDULE OF NONCASH CAPITAL ACTIVITIES:

Retirement of capital assets	<u>\$ 49,256</u>
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See accompanying notes to basic financial statements.



**PUERTO RICO TOURISM COMPANY
SLOT MACHINES OPERATIONS**

(A Proprietary Fund of the Puerto Rico Tourism Company)

Notes to Basic Financial Statements
Fiscal Year Ended June 30, 2016

(1) Reporting Entity

The Puerto Rico Tourism Company Slot Machines Operations (the Slot Machines Operations) is a business-type activity of Puerto Rico Tourism Company (the Company) and is included as a proprietary fund in the Company's basic financial statements. The Company is a component unit of the Commonwealth of Puerto Rico (the Commonwealth) created by Act No. 10 of 1970 for the development of the tourism industry in Puerto Rico. The Slot Machines Operations' are exempt from the payment of taxes.

These financial statements present only the Slot Machines Operations and do not purport to, and do not, present fairly the financial position of the Company as of June 30, 2016, and the statement of changes in financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

(2) Basis for Presentation and Summary of Significant Accounting Policies

The accounting and reporting policies of the Slot Machines Operations conform to accounting principles generally accepted in the United States of America (US GAAP) for governments as prescribed by the Governmental Accounting Standards Board (GASB).

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

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Proprietary fund basic financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred, regardless of the timing of related cash flows. The proprietary funds account for those activities for which the intent of management is to recover, primarily through user charges, the cost of providing goods or services to the general public.

The statement of net position presents the Slot Machines Operations' assets and liabilities, with the difference reported as net position. Net position is reported in three categories:

- *Net Investment in Capital Assets* – This component of net position consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction or improvement of those assets or related debt are included in this component of net position. If there are significant unspent related debt proceeds or deferred inflows of resources at year end, the portion of the debt or deferred inflows of resources attributable to the unspent amount is not included in the calculation of this component of net position. Rather, that portion of the debt or deferred inflows of resources is included in the same net position component (restricted or unrestricted) as the unspent amount.
- *Restricted* – This component of net position consists of restricted assets and deferred outflows of resources reduced by related liabilities and deferred inflows of resources. Generally, a liability relates to restricted assets if the assets results from a resource flow that also results in the recognition of a liability or if a liability will be liquidated with the restricted assets reported.

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- *Unrestricted* – This component of net position is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position. When both restricted and unrestricted resources are available for use, it is Slot Machines Operations' policy to use restricted resources first and the unrestricted resources when they are needed.

The statement of activities distinguishes operating revenues and expenses from non-operating items. The operating revenues of the Slot Machines Operations are principally generated from the activities related to the collection of funds from the slot machines located in the different casinos of Puerto Rico, less the payments of jackpots and hopper fills. Operating expenses include payroll and related-payroll benefits, depreciation and amortization, rent and other. Revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

Capital Assets

Capital assets, which include furniture and equipment, are stated at cost. Capital assets are defined by management as assets with a cost of \$500 or more at the date of acquisition and an expected useful life of three or more years. Purchased capital assets are valued at historical cost or estimated historical cost. Donated capital assets are recorded at the fair value at the date of donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are expensed. Depreciation is provided on a straight-line method over the estimated useful life of the furniture and equipment that ranges from 3 to 7 years.

Interfund Activities

Slot Machines Operations has the following types of interfund transactions:

Loans – Represents amounts provided with a requirement for repayment. Interfund loans are reported as interfund receivables (due from other funds) in lender funds and interfund payables (i.e. due to other funds) in borrower funds. Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset equally by nonspendable fund balance which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

Transfers – Represents flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. In governmental funds, transfers are reported as other financing uses in the fund making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers are reported after nonoperating revenues and expenses.

Compensated Absences

Employees are granted 30 days of vacation and 18 days of sick leave annually. Vacations and sick leave may be accumulated up to a maximum of 60 and 90 days, respectively. In the event of employee resignation, such employee is reimbursed for its accumulated vacation days and for sick leave up to the maximum allowed. For sick leave, in the event of employee resignation, the employee is paid up to the maximum allowed if the employee has worked with the Company or any other instrumentality of the Commonwealth for 10 years or more, and up to 40% of the accumulated amount if the employee has worked between 1 to 10 years. Pursuant to Act No. 66 of 2014, the requirement to pay the employees balances in excess over maximum days of sick and vacations was eliminated.



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The liability for compensated absences reported in the Slot Machines Operations financial statements has been calculated using the vesting method, in which leave amounts for both employees who currently are eligible to receive termination payments, and other employees who are expected to become eligible in the future to receive such payments upon termination are included. The liability has been calculated based on the employees' current salary level and includes salary related costs (e.g., social security and medicare tax).

Risk Management

The Company purchases commercial insurance to cover for casualty, theft, tort claims, and other losses through the Puerto Rico Treasury Department negotiated under a blanket agreement and then charged to the Slot Machines Operations. The current insurance policies have not been canceled or terminated. There have been no settlements of insurance claims that exceed coverage under such policies in any of the past three years.

Deferral of Accounting Pronouncement

The Company is required to adopt the provision of GASB Statement No. 68 Accounting and Financial Reporting for Pensions (GASB 68) - an amendment of GASB Statement No. 27, and Statement No. 71, Pension Transition for Contributions Made Subsequent to the Measurement Date, an amendment of GASB Statement No. 68 (GASB No.71). These statements were effective for fiscal years beginning after June 15, 2014. The primary objective of GASB 68, as amended by GASB Statement 71, is to improve accounting and financial reporting by state and local government for pensions. It also improves information provided by state and local governmental employers for pensions about financial support for pensions that is provided by other entities. This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governments Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trust or equivalent arrangements that meet certain criteria.

The adoption of GASB Statements No. 68 and 71 requires the Company to obtain from the Employees' Retirement System of the Commonwealth of Puerto Rico, a statutory trust and component Unit of the Commonwealth of Puerto Rico, technical information regarding actuarial valuations, discount rates, the Company's proportionate share of the net pension liability and deferred outflows and inflows of resources, as these relates to pension costs. As of June 30, 2016, and in spite of several formal requests from the Company's management the Employees' Retirement System of the Commonwealth of Puerto Rico did not provide the Company with the required audited information. Therefore, the Company was unable to adopt the dispositions of GASB Statements No. 68 and 71.

Recognition of these amounts would increase liabilities, increase deferred outflows of resources, increase deferred inflows of resources, increase deficit, and change the pension expense.

Future Accounting Pronouncements

The GASB has issued the following accounting pronouncements that may have a future impact on the accounting and financial reporting of the Slot Machines Operation:

GASB Statement No. 73, Accounting and Financial Reporting for Pensions and Related Assets That Are Not within Scope of GASB Statement No. 68, and Amendments to Certain Provisions of GASB No. 67 and 68, which is effective for periods beginning after June 15, 2016.

GASB Statement No. 74, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans, which is effective for periods beginning after June 15, 2016.



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GASB Statement No. 75, Accounting and Financial Reporting for Postemployment Benefit Other Than Pensions, which is effective for periods beginning after June 15, 2017.

GASB Statement No. 77, Tax Abatement Disclosures, which is effective for periods beginning after December 15, 2015.

GASB Statement No. 78, Pensions Provided through Certain Multiple Employer Defined Benefit Pension Plans, which is effective for periods beginning after December 15, 2015.

GASB Statement No. 79, Certain External Investment Pools Participants, which is effective for periods beginning after June 15, 2015, except for certain provisions on portfolio quality, custodial credit risk and shadow pricing that are effective for periods beginning after December 15, 2015.

GASB Statement No. 80, Blending Requirements for Certain Components Units – An Amendment of GASB Statement No. 14, which is effective for periods beginning after June 15, 2016.

GASB Statement No. 81, Irrevocable Split Interest Agreements, which is effective for periods beginning after December 15, 2016.

GASB Statement No. 82, Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73, which is effective for periods beginning after June 15, 2016, except for certain dispositions related to the selection of assumptions that are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017.

GASB Statement No. 83, Certain Assets Retirement Obligations, which is effective for periods beginning after June 15, 2018.

Management is evaluating the impact that these statements will have, if any, on the Company's basic financial statements.

(3) Due from Puerto Rico Tourism Company's General Fund

The amount due from the Company's general fund as of June 30, 2016, amounted to approximately \$21.9 million. Such amount is related to excess cash transferred to the general fund of the Company for cash management purposes. Amounts due from the Company's general fund do not bear interest and are due on demand.

(4) Capital Assets

Capital assets activity for the year ended June 30, 2016, was as follows:

Description	Beginning Balance	Additions	Reductions and Adjustments	Ending Balance
Furniture and equipment being depreciated	\$ 995,005	\$ 1,178	\$ (1,947)	\$ 994,236
Less accumulated depreciation and amortization	(982,622)	(29,056)	1,947	(1,009,731)
Other adjustments	-	47,311	-	47,311
	<u>\$ 12,383</u>	<u>\$ 19,433</u>	<u>\$ -</u>	<u>\$ 31,816</u>



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(5) Long-Term Obligations

The activity for long-term obligations during the year ended June 30, 2016 is as follows:

<u>Description</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Due Within One Year</u>
Accrued compensated absences	\$ 2,878,459	\$ 116,274	\$ (186,178)	\$ 2,808,555	\$ 1,015,444
Accrued christmas bonus	130,468	104,156	(109,086)	125,538	125,538
	<u>\$ 3,008,927</u>	<u>\$ 220,430</u>	<u>\$ (295,264)</u>	<u>\$ 2,934,093</u>	<u>\$ 1,140,982</u>

On June 17, 2014, the Commonwealth signed into law Act No. 66 (also known as Fiscal Operation and Sustainability Act), which declared a state of fiscal emergency in order to adopt a plan to manage the economic consequences of the Commonwealth credit rating downgrade, and to establish expenditures reduction measures and a structured management in order to satisfy the commitments of the Commonwealth. This Act establishes as public policy the restoration of the Commonwealth's investment-grade credit rating through the short term elimination of the Commonwealth's general fund deficit and the improvement of the public corporation's fiscal condition. Act No. 66 imposes on the public corporations cost reduction measures such as: (i) reduction of at least 10% of external professional services contracts; (ii) authorization to adjust unilaterally the professional services rates; (iii) reduction of at least 10% of the trusted employees; (iv) freezing period for new recruitment of employees; (v) the public corporations cannot provide salary increases or increase benefits to the employees; (vi) establishment of a maximum amount of \$600 for Christmas bonus and \$200 for summer bonus; (vii) elimination of payment of balances in excess over a maximum days of sick and vacation accruals; (viii) and other cost reduction measures. For the fiscal year ended June 30, 2016, the Company certified approximately \$800 thousands due to Commonwealth as a result of Act No. 66 implementation.

(6) Retirement System

Defined-Benefit Pension Plan

The Retirement System is a cost-sharing multiple-employer defined-benefit pension plan sponsored by, and reported as a component unit of the Commonwealth.

The Retirement System was created under Act No. 447 (the Act), approved on May 15, 1951, as amended, and became effective on January 1, 1952. All regular appointed and temporary employees of the Slot Machines Operations hired before January 1, 2000, under 55 years of age at the date of employment became members of the Retirement System as a condition of their employment. No benefits are payable if the participant receives a refund of accumulated contributions.

The Retirement System provides retirement, death, and disability benefits pursuant to legislation enacted by the Commonwealth's legislature. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits generally vest after 10 years of plan participation. Disability benefits are available to members for occupational and non-occupational disabilities. However, a member must have at least 10 years of service to receive non-occupational disability benefits.

Retirement benefits are determined by the application of stipulated benefit ratios to the member's average compensation. Average compensation is computed based on the highest 36 months of compensation recognized by the Retirement System. The annuity, for which a plan member is eligible, is limited to a minimum of \$400 per month and a maximum of 75% of the average compensation.



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Contribution requirements, which are established by law and are not actuarially determined, are as follows:

Company	9.275% of applicable payroll
Employees:	
Hired on or before March 31, 1990	5.775% of monthly gross salary for the first \$550
	8.275% of monthly gross salary for the excess over \$550
Hired on or after April 1, 1990	8.275% of monthly gross salary

On April 4, 2013, the Governor signed into law Act No. 3 of 2013 (Act No. 3), which adopted a comprehensive reform of the Retirement System, that is funded primarily with budget appropriations from the Commonwealth's General Fund.

With the enactment of Act No. 3, and taking into account an additional annual contribution of \$140 million for the next 20 years by the Commonwealth, it's expected that the cash funding shortfall of the Retirement System will be eliminated in the long term. Act No. 3, however, does not eliminate the need for the Commonwealth to make additional contributions to the Retirement System.

System 2000

On September 24, 1999, an amendment to the Act, which created the Retirement System, was enacted to provide a new benefit structure, similar to a cash balance plan, known as System 2000.

Employees participating in the Retirement System as of December 31, 1999 were allowed to stay in the defined benefit structure or transfer to System 2000. Employees joining the public sector on or after January 1, 2000, are only allowed to become members of System 2000. Under System 2000, contributions received from participants and employees are pooled and invested by the Retirement System, together with the assets corresponding to the defined benefit structure. There are no separate accounts for System 2000 participants. Future benefit payments under the original defined benefit structure and System 2000 will be paid from the same pool of assets.

The annuity is based on a formula, which assumes that each year the participants' contribution (with a minimum of 8.275% of the participants' salary up to a maximum of 10%) will be invested as instructed by the participant in an account, which will either (1) earn a fixed rate based on the two-year constant maturity treasury notes, (2) earn a rate equal to 75% of the return of the Retirement System's investment portfolio (net of management fees), or (3) earn a combination of both alternatives. Disability benefits are not granted under System 2000. The employers' contribution amounts to 9.275% of the employee's salary. System 2000 reduces the retirement age from 65 years to 60 years for those employees who joined the public sector on or after January 1, 2000.

On July 6, 2011, Act No. 116 was approved to increase the employer's contributions for each participant and the employees' contributions. Starting on July 1, 2011, the employer's contribution will be 10.275% and will increase annually by 1% until June 30, 2016. Effective July 1, 2016, the employer's contribution will increase by 1.25% annually until reaching 20.25%. The employees' contributions will be 10.25% of monthly gross salary.

Total employee contributions to the Retirement System, including System 2000, during the year ended June 30, 2016, amounted to approximately \$907,000. The Slot Machines Operations' contributions for the years ended June 30, 2016, 2015, 2014, 2013, and 2012, amounted to approximately \$925,000, \$879,000, \$737,000, \$704,000 and \$512,000, respectively, equal to the required annual contributions.



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With the purpose of solving the Additional Benefit Program and the Retirement System, beginning fiscal year 2013-2014 and each subsequent fiscal year. The Retirement System will receive a contribution equal to two thousand (\$2,000) at July 1 of each year for each retiree who began Public Service on or before December 31, 1999.

On April 4, 2013, the Commonwealth enacted Act No. 3 to amend the Act and restructure the Retirement System. The main amendments under Act No. 3, include the freezing of benefit accruals of all participants under the defined benefit structure of the Retirement System, an increase in the retirement age of all participants, and an increase in the mandatory employee contributions to 10% of their monthly gross salary, among others. The provisions of Act No. 3 are effective on July 1, 2013.

Postemployment Benefits

The Company provides to certain employees covered under a collective bargaining agreement, a postemployment benefit that includes six months of medical insurance after voluntary termination under an early retirement termination plan. Information and related accruals required under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, has not been included in the accompanying financial statements since the required information is not readily available. Management asserts that additional disclosures and the effect on the financial statement effect are not considered significant, considering the limited number of employees that are covered under this agreement.

Hybrid Program of Defined Contribution

This program was created under Section 15 of Act No.3 which consists in establishing an account with the individual contributions of each participant of the System that becomes part of the program.

To qualify for this program, participants must be employed during or after July 1, 2013. Every participant will have to contribute ten percent (10%) of their remuneration to their account during employment.

Participants of the system that at June 30, 2013 were covered by the Coordination Plan with the Social Security benefits will contribute:

Effective as of July 1, 2013	7% of monthly gross salary for the first \$550 10% of the monthly gross salary for the excess over \$550
Effective as of July 1, 2014	8.5% of monthly gross salary for the first \$550 10% of the monthly gross salary for the excess over \$550
Effective as of July 1, 2015	10% of the total retribution

As described in Note 2 under Deferral of Accounting Pronouncement, GASB Statements No. 68 and 71, became effective since the year ended June 30, 2015. These statements replace the requirements of GASB Statement No. 27, as well as the requirements of Statement No. 50, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the Retirement System. GASB Statements No. 68 and 71 will bring the effect of the implementation of GASB Statement No. 67 in the Retirement System into the accounting records of the individual agencies, component units and municipalities, whose employees participate in the Retirement System. The Commonwealth, as well as its component units and the municipalities, are considered "cost-sharing" employers of the Retirement System; therefore, they must report their allocated share of the Commonwealth's resulting net pension liability from GASB Statement No. 67. The Commonwealth and the Retirement System are still in the process of evaluating the impact of GASB 68 and 71 and have not provided the Company with the necessary information as of June 30, 2016 to adopt GASB 68 and 71, including its allocated share of the net pension liability mentioned above. Accordingly, these financial statements do not contain any adjustments, disclosures or required supplementary information required by GASB 68 and 71.



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(7) Voluntary Retirement Program

On December 8, 2015, Act No. 211-2015 was approved to create a voluntary retirement program. The Act establishes that employees who have been working for the Commonwealth of Puerto Rico and enrolled in the Retirement System before April 1, 1990 with at least 20 years of service may be eligible to participate in the program. Those who participate in the program would receive a compensation equal to sixty percent (60%) of the employee's average compensation as of December 31, 2015; the payment of unused vacation and sick leave; the payment of employer contributions on account of Social Security and Medicare; and the payment of the participant's healthcare plan during the first two years of the program. This program also provides for the employer to continue making both individual and employee contributions to the Retirement System. As of June 30, 2016, no employees have elected to participate in the voluntary retirement program.

(8) Distributions from Slot Machines Operations

Pursuant to Act No. 24 approved on June 26, 1997, the percentage of distributions of Slot Machines Operations for fiscal years commencing after 2001 is computed as follows:

Description	Casino Concessionaries	Governmental entities
Base income	34%	66%
Excess over base income	60%	40%

The governmental entities' participation in the operating income is as follows:

Description	Percentage
Commonwealth	15.15%
University of Puerto Rico	45.45%
Puerto Rico Tourism Company's General Fund	39.40%

(9) Due to Related Entities

The unremitted distribution to the Commonwealth and the University of Puerto Rico as of June 30, 2016, amounted to approximately \$1.7 million and \$5.2 million, respectively, as reflected in the accompanying statement of net position.

(10) Uncertainties Impacting the Slot Machines Operations

Organic Act of the Fiscal Oversight and Economic Recovery Board – On December 8, 2015, Act No. 208-2015, was approved to create a five-member fiscal and economic oversight board, to be known as the "Puerto Rico Fiscal Oversight and Economic Recovery Board" (the Board). The Board will have fiscal oversight authority over each public entity of the Commonwealth, including the Company. The Board will be charged with (a) reviewing and approving the Fiscal Economic Growth Plan (FEGP), (b) reviewing the annual budgets of the public entities subject to its fiscal oversight authority, and (c) monitoring compliance with such budgets.



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Puerto Rico Emergency Moratorium and Financial Rehabilitation Act – On April 6, 2016, the Governor of the Commonwealth signed into law the Puerto Rico Emergency Moratorium and Rehabilitation Act (Act No. 21). Among other objectives, Act No. 21 allows the Governor of the Commonwealth of Puerto Rico to declare a moratorium on debt service payments and to stay related creditor remedies for a temporary period for the Commonwealth and its component units. The temporary period set forth in Act No. 21 lasts until January 2017, with a possible two-month extension at the Governor's discretion. The moratorium and stay provisions of Act No. 21 require executive actions of the Governor to become effective.

Pursuant to Act No. 21, on April 8, 2016, the Governor of the Commonwealth signed Executive Order EO 2016-10, declaring Government Development Bank (GDB) to be in a state of emergency. In accordance with the emergency powers provided in Act No. 21, EO 2016-10 implemented a regulatory framework governing GDB's operations and liquidity, including prohibiting loan disbursements by GDB and establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB. To that effect, EO 2016-10 restricts the withdrawal, payment and transfer of funds held on deposit at GDB to those reasonable and necessary to ensure the provision of essential services and authorizes GDB to establish weekly limits on the aggregate amount of such disbursements. The procedures implemented by EO 2016-10 result in restrictions on the ability of the Company to withdraw funds held on deposit at GDB.

Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) – On June 30, 2016, the President of the United States signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which grants the Commonwealth of Puerto Rico and its component units' access to an orderly mechanism to restructure their debts in exchange for significant federal oversight over the Commonwealth of Puerto Rico's Finances. PROMESA seeks to provide Puerto Rico with fiscal and economic discipline through the creation of a control board, relief from creditor lawsuits through the enactment of a temporary stay on litigation, and two alternative methods to adjust unsustainable debt.

(11) Subsequent events

Voluntary Work Week Reduction – On July 30, 2016, the Governor of the Commonwealth signed Law 100 of 2016, which allows governmental employees to reduce voluntarily, and in agreement with the employer, the work week to thirty-two (32) hours and reduces salary to 80% of the gross salary.

Management has evaluated subsequent events through December 12, 2016, the date on which financial statements were available to be issued.