



**PUERTO RICO FISCAL AGENCY AND
FINANCIAL ADVISORY AUTHORITY**
(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required Supplementary Information
As of June 30, 2017 and for the period from inception (July 18, 2016) to
June 30, 2017
(With Independent Auditors' Report Thereon)

**PUERTO RICO FISCAL AGENCY AND
FINANCIAL ADVISORY AUTHORITY**
(A Component Unit of the Commonwealth of Puerto Rico)



Basic Financial Statements and Required Supplementary Information
As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017

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INDEPENDENT AUDITOR'S REPORT

To: The Board of Directors of the
Puerto Rico Fiscal Agency and Financial Advisory Authority

Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Fiscal Agency and Financial Advisory Authority, a Component Unit of the Commonwealth of Puerto Rico, as of and for the period from inception (July 18, 2016) to June 30, 2017, which collectively comprise Puerto Rico Fiscal Agency and Financial Advisory Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the governmental activities of Puerto Rico Fiscal Agency and Financial Advisory Authority as of June 30, 2017, and the respective changes in financial position thereof for the period from inception (July 18, 2016) to June 30, 2017, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Uncertainty

The accompanying financial statements have been prepared assuming the Authority will continue as a going concern. The Authority is a Component Unit of the Commonwealth of Puerto Rico, which as described in the Note 8, approved appropriations to the Authority of approximately \$38.8 million from the governmental funds during the period from inception (July 18, 2016) to June 30, 2017. As described in Note 3, the Commonwealth is in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations.

Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services.

The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations contributed to significant budget deficits for several years, which deficits the Commonwealth financed, further increasing the amount of its debt. These matters and the Commonwealth's liquidity constraints, among other factors, adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all.

Since June 30, 2014, the principal rating agencies have continued to lower their rating on the general obligation bonds of the Commonwealth, which had already been placed in a default rating of "D".

The Primary Government reflects a net deficit of approximately \$70.3 billion as of June 30, 2016. The Commonwealth's General Fund shows a fund deficit of approximately \$1.2 billion as of June 30, 2016.

These factors have also resulted in delays in the repayment by the Commonwealth and its component units of outstanding GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and have caused GDB to fail to make a principal payment on its debt obligations.

The financial statements do not include any adjustment that may result from the outcome of this uncertainty. Our opinion is not modified with respect to this matter.

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 4 to 8 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
September 6, 2019.

Stamp No. E392328 was affixed
to the original of this report



PUERTO RICO FISCAL AGENCY AND FINANCIAL ADVISORY AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017

This section presents a narrative overview and analysis of the financial performance of Puerto Rico Fiscal Agency and Financial Advisory Authority (the Authority) and is designed to assist the reader in focusing on significant financial issues, provide an overview of the Authority's financial activity, identify changes in the Authority's financial position, and identify individual issues or concerns. The information presented here should be read in conjunction with the basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- Total Assets amounted to \$19,370,859 as of June 30, 2017.
- Total Liabilities amounted to \$16,753,013 as of June 30, 2017.
- Net Position amounted to \$2,617,846 as of June 30, 2017.
- Commonwealth appropriations amounted to \$38,813,804 for the period from inception (July 18, 2016) to June 30, 2017.
- Change in Net Position amounted to \$2,617,846 for the period from inception (July 18, 2016) to June 30, 2017.
- The Commonwealth and most of its public corporations are in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the Commonwealth's General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations contributed to significant budget deficits for several years. On December 1, 2015, the Governor of Puerto Rico signed Executive Order No. OE-2015-46, which provides that the Commonwealth will begin to redirect certain revenues in light of recently revised revenues estimates and its deteriorating liquidity situation. On April 2016, the Legislature of Puerto Rico enacted the Act 21 of 2016, known as the "Puerto Rico Emergency Moratorium and Financial Rehabilitation Act". Based on the provisions of the Act 21 of 2016, the Commonwealth and certain other governmental instrumentalities suspended the payment of debt service on their respective debts. Since the enactment of the Moratorium Act, the Governor of Puerto Rico adopted a series of additional executive orders pursuant thereto declaring an emergency period and moratorium with respect to certain debt obligations of the Commonwealth and certain other governmental instrumentalities.

OVERVIEW OF THE FINANCIAL STATEMENTS

This management's discussion and analysis is required supplementary information to the basic financial statements and is intended to serve as an introduction to the basic financial statements of the Authority. The basic financial statements comprise three components: (1) government-wide financial statements, (2) fund financial statements and, (3) notes to the basic financial statements.

PUERTO RICO FISCAL AGENCY AND FINANCIAL ADVISORY AUTHORITY (A Component Unit of the Commonwealth of Puerto Rico)

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017

Government-wide Financial Statements – The government-wide financial statements provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business. The statements provide both short and long-term information about the Authority's financial position, which assists in assessing the Authority's economic condition at the end of the fiscal year. These are prepared using the economic resources measurement focus and the accrual basis of accounting. This means they follow methods that are similar to those used by private nongovernmental organizations. They take into account all revenues and expenses connected with the fiscal year even if cash involved has not been received or paid.

The government-wide financial statements include two statements:

- **Statement of Net Position** – This statement presents all of the government's assets, deferred outflows of resources, liabilities and deferred inflow of resources. Net position is the difference between (a) assets and deferred outflows of resources, and (b) liabilities and deferred inflows of resources. Over time, increases or decreases in the Authority's net position may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.
- **Statement of Activities** – This statement presents information showing how the Authority's net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenue and expenses are reported in the statement for some items that will not result in cash flows until future fiscal periods.

The government-wide financial statements can be found immediately following this Management's Discussion and Analysis.

Fund Financial Statements – A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives.

The Authority uses a governmental fund type for operations.

- **Governmental Funds Financial Statements** – These statements focus on near-term inflows and outflows of spendable resources, as well as on balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating the Authority's near-term financing requirements. Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements.

By doing so, readers may better understand the long-term impact of financial decisions related to the Authority's governmental activities. Both, the governmental funds balance sheet and the governmental funds statement of revenues, expenditures, and change in fund balance, provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

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

**PUERTO RICO FISCAL AGENCY AND
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(A Component Unit of the Commonwealth of Puerto Rico)**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017**

GOVERNMENT – WIDE FINANCIAL ANALYSIS

Governmental entities are required by accounting principles generally accepted in the United States of America ("GAAP"), as prescribed by the Governmental Accounting Standard Board ("GASB"), to report on their net position. The Statement of Net Position presents the value of all of the Authority's assets and deferred outflow of resources, and liabilities and deferred inflow of resources, with the difference between them reported as net position.

The following was derived from the Statement of Net Position as of June 30, 2017:

ASSETS:

Current assets	\$ 19,317,600
Capital asset	<u>53,259</u>
Total assets	<u>19,370,859</u>

LIABILITIES AND NET POSITION:

Liabilities:

Liabilities due within one year	14,872,740
Liabilities due after one year	<u>1,880,273</u>
Total Liabilities	<u>16,753,013</u>

Net Position:

Net investment in capital assets	53,259
Unrestricted	<u>2,564,587</u>
Total Net Position	<u>\$ 2,617,846</u>

**PUERTO RICO FISCAL AGENCY AND
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017**

A condensed summary of activities for the period from inception (July 18, 2016) to June 30, 2017, is presented below:

REVENUES:

Contributions from Commonwealth of Puerto Rico	\$ 38,813,804
Fiscal agency fees	679,107
Interest income	15,324
	<hr/>
Total revenues	39,508,235

EXPENSES:

Legal and professional fees	26,409,130
Other expenses	6,192,672
Salaries and fringe benefits	3,521,974
Office and administrative	650,772
Occupancy and equipment costs	115,841
	<hr/>
Total expenses	36,890,389
Change in net position	2,617,846

NET POSITION – Beginning of year	<hr/> -
NET POSITION – End of year	<hr/> \$ 2,617,846

CURRENTLY KNOWN FACTS

The following is a summary description of currently known facts, decisions, and conditions that have had, or are expected to have, a significant effect on the Authority's financial position and results of operations.

Significant Legislation

On April 6, 2016, Act No. 21 "Emergency Moratorium and Financial Rehabilitation Act" (Act No. 21) was approved creating the Authority as an independent public corporation and government instrumentality with separate legal existence, fiscal and administrative autonomy, and independence from the Commonwealth. The Authority was created for the purpose of acting as fiscal agent, financial advisor and reporting agent of the Government of Puerto Rico, its agencies, instrumentalities, subdivisions, public corporations and/or municipalities, and to assist such entities in confronting the fiscal and economic emergency that Puerto Rico is experiencing. The Authority assumed the fiscal agency and financial advisory responsibilities that were previously held by the Government Development Bank (GDB). On January 18, 2017, the Governor signed into law the Enabling Act of the Fiscal Agency and Financial Advisory Authority, Act No. 2 of 2017. This new law amended and replaced sections of the prior law that established the Authority. Act No. 2 of 2017 expanded the Authority's powers to include, among other things, sole responsibility to renegotiate, to restructure and/or to reach an agreement with creditors on all or part of the public debt or any other debt issued by any government entity. In addition, the Authority is the entity in charge of the collaboration, communication and cooperation efforts between the Government of Puerto Rico and the Oversight Board, created under the Puerto Rico Oversight, Management, and Economic Stability Act, Pub. L. 114-187 (PROMESA).

**PUERTO RICO FISCAL AGENCY AND
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**MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
As of June 30, 2017 and for the period from inception (July 18, 2016) to June 30, 2017**

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

On June 30, 2016, President Obama signed into law the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"). The Act would create a structure for exercising federal oversight over the fiscal affairs of territories. PROMESA would: (a) establish an Oversight Board with broad powers of budgetary and financial control over Puerto Rico; and (b) create procedures for adjusting debts accumulated by the Puerto Rico government and its instrumentalities and potentially for debts of other territories. Other diverse provisions of the Act include: (1) the Puerto Rico's right to determine its future political status, (2) the authority of the Governor to reduce the minimum wage for most workers in Puerto Rico under the age of 25 for a four-year period (with board approval), (3) an automatic stay on litigation, and (4) an accelerated processes for the review and approval of permitting related to infrastructure projects designated as "Critical Projects".

Act 106 of 2017

On June 27, 2017, the Treasury Department of Puerto Rico 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, the new "pay-as-you-go (PayGo)" mechanism for all of the Commonwealth's Retirement Systems. With the start of the fiscal year 2017, employers' contributions, contributions ordered by special laws, and the Additional Uniform Contribution were all eliminated and replaced by a monthly PayGo charge that will be collected from the aforementioned government entities to pay retirees. The Retirement Systems will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality.

REQUEST FOR INFORMATION

This financial report is designed to provide all interested with a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Executive Director, Puerto Rico Fiscal Agency and Financial Advisory Authority, P.O. Box 42001, San Juan, Puerto Rico, 00940-2001.



**PUERTO RICO FISCAL AGENCY AND
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STATEMENT OF NET POSITION
June 30, 2017

ASSETS

Cash	\$ 16,066,951
Accounts receivable	3,173,286
Prepaid expenses	77,363
Capital asset	<u>53,259</u>
Total assets	<u>19,370,859</u>

LIABILITIES AND NET POSITION

Liabilities:

Accounts payable and accrued liabilities	14,212,258
Compensated absences	287,314
Termination benefits	1,880,273
Due to Government Development Bank for Puerto Rico	<u>373,168</u>
Total liabilities	<u>16,753,013</u>

NET POSITION

Net investment in capital assets	53,259
Unrestricted	<u>2,564,587</u>
Total net position	<u>\$ 2,617,846</u>

The accompanying notes are an integral part of this financial statement.



**PUERTO RICO FISCAL AGENCY AND
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(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF ACTIVITIES
For the period from inception (July 18, 2016) to June 30, 2017

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Program revenues contributions</u>	<u>Net Revenue and changes in net position</u>
GOVERNMENTAL ACTIVITIES:			
Contribution from Commonwealth of Puerto Rico	\$ -	\$ 38,813,804	\$ 38,813,804
Legal and professional fees	26,409,130	-	(26,409,130)
Other expenses	6,192,672	-	(6,192,672)
Salaries and fringe benefits	3,521,974	-	(3,521,974)
Office and administrative	650,772	-	(650,772)
Occupancy and equipment costs	115,841	-	(115,841)
Total governmental activities	<u>\$ 36,890,389</u>	<u>\$ 38,813,804</u>	<u>1,923,415</u>
GENERAL REVENUES:			
Fiscal agency fees			679,107
Interest income			<u>15,324</u>
Total general revenues			<u>694,431</u>
CHANGE IN NET POSITION			2,617,846
NET POSITION – Beginning of year			<u>-</u>
NET POSITION – End of year			<u>\$ 2,617,846</u>

The accompanying notes are an integral part of this financial statement.



**PUERTO RICO FISCAL AGENCY AND
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**BALANCE SHEET — GOVERNMENTAL FUNDS
June 30, 2017**

	<u>General Fund</u>
ASSETS	
Cash	\$ 16,066,951
Accounts receivable	<u>3,173,286</u>
Total assets	<u>\$ 19,240,237</u>
LIABILITIES AND FUND BALANCE	
Liabilities:	
Accounts payable and accrued liabilities	\$ 14,212,258
Compensated absences	287,314
Due to Government Development Bank for Puerto Rico	<u>373,168</u>
Total liabilities	14,872,740
Fund balance unassigned	<u>4,367,497</u>
Total liabilities and fund balance	<u>\$ 19,240,237</u>

The accompanying notes are an integral part of this financial statement.



**PUERTO RICO FISCAL AGENCY AND
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**RECONCILIATION OF THE BALANCE SHEET – GOVERNMENTAL FUNDS TO THE
STATEMENT OF NET POSITION
June 30, 2017**

FUND BALANCE OF GOVERNMENTAL FUNDS	\$ 4,367,497
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES IN THE STATEMENT OF NET POSITION ARE DIFFERENT BECAUSE:	
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.	53,259
Prepaid expenses are not available to pay current period expenditures and, therefore, are not deferred in the funds.	77,363
Termination benefits are not due and payable currently, therefore, are not reported in the funds.	<u>(1,880,273)</u>
NET POSITION OF GOVERNMENTAL ACTIVITIES	<u><u>\$ 2,617,846</u></u>

The accompanying notes are an integral part of this financial statement.



**PUERTO RICO FISCAL AGENCY AND
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**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGE IN FUND
BALANCE – GOVERNMENTAL FUNDS
For the period from inception (July 18, 2016) to June 30, 2017**

	<u>General Fund</u>
REVENUES:	
Contributions from Commonwealth of Puerto Rico	\$ 38,813,804
Fiscal agency fees	679,107
Interest income	15,324
	<hr/>
Total revenues	39,508,235
	<hr/>
EXPENDITURES:	
Legal and professional fees	26,409,130
Other expenses	4,312,399
Salaries and fringe benefits	3,521,974
Office and administrative	728,135
Occupancy and equipment costs	115,841
Capital expenditures	53,259
	<hr/>
Total expenditures	35,140,738
	<hr/>
EXCESS OF REVENUES OVER EXPENDITURES	4,367,497
	<hr/>
NET CHANGE IN FUND BALANCE	4,367,497
	<hr/>
FUND BALANCE – Beginning of year	-
	<hr/>
FUND BALANCE – End of year	<u>\$ 4,367,497</u>

The accompanying notes are an integral part of this financial statement.



**PUERTO RICO FISCAL AGENCY AND
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**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGE
IN FUND BALANCE – GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES
For the period from inception (July 18, 2016) to June 30, 2017**

NET CHANGE IN FUND BALANCE – GOVERNMENTAL FUNDS \$ 4,367,497

**AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES
IN THE STATEMENT OF ACTIVITIES ARE DIFFERENT BECAUSE:**

Government funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. 53,259

Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds. (1,802,910)

CHANGE IN NET FUND BALANCE OF GOVERNMENTAL ACTIVITIES \$ 2,617,846

The accompanying notes are an integral part of this financial statement.

**PUERTO RICO FISCAL AGENCY AND
FINANCIAL ADVISORY AUTHORITY**
(A Component Unit of the Commonwealth of Puerto Rico)



NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2017

1. REPORTING ENTITY

Puerto Rico Fiscal Agency and Financial Advisory Authority (the Authority) is a Component Unit of the Commonwealth of Puerto Rico (the Commonwealth). The Authority was originally created by Act No. 21 of April 6, 2016, which was amended by Act No. 2 of January 19, 2017 (the Act No. 2). The Authority began operations on July 18, 2016. The Authority has the responsibility to: oversee compliance with the certified budget and fiscal plan approved pursuant to the Puerto Rico Oversight, Management, and Economic Stability Act of 2016; revise matters including, but not limited to, agreements, transactions, and regulations of the agencies and instrumentalities of the Government of Puerto Rico; enter into a creditors' agreement, and/or renegotiate or restructure the public debt, in whole or in part, or any other debt issued by any Government body including, but not limited to agencies, boards, commissions, instrumentalities, public corporations or applicable political subdivision. The accompanying financial statements present the net position and results of operations of the entity as a whole and by major funds that are governed by the Authority.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Authority conform to accounting principles generally accepted in the United States of America ("U.S. GAAP") for governments as prescribed by the Governmental Accounting Standard Board ("GASB").

The preparation of basic financial statements in conformity with U.S. 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 financial statements, and the reported amounts of revenues and expenses/expenditures during the reporting period. Actual results could differ from those estimates.

Following is a description of the Authority's most significant accounting policies:

Government-Wide Financial Statements

The government-wide financial statements (the statement of net position and the statement of activities) report information of all the activities of the Authority. Governmental activities are financed mainly through contributions from the Commonwealth of Puerto Rico. The statement of net position presents the Authority's assets, deferred outflows of resources, liabilities, and deferred inflows of resources, with the residual measure 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 the outstanding balance of any bonds, mortgages, notes, or other borrowings that are directly attributable to the acquisition, construction, or improvement of those assets. Deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt also should be 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.

**PUERTO RICO FISCAL AGENCY AND
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NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2017

- **Restricted Net Position** – 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. Restricted assets result when constraints placed on those assets use are either, externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Position** – 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, generally, it is the Authority's policy to use restricted resources first, then the unrestricted resources as they are needed.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenue. Direct expenses are those that are clearly identifiable with a specific function or segment. The Authority does not allocate general government (indirect) expense to other functions. Program revenue includes charges to customers who purchase, use, or directly benefit from goods or services provided by a given function or segment. Program revenue also includes grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Revenue that is not classified as program revenue is presented as general revenue. Resources that are dedicated internally are reported as general revenue rather than as program revenue.

Fund Financial Statements

The Authority reports its financial position and results of operations in funds, which are considered separate accounting entities. The operations of each fund are accounted for within a set of self-balancing accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions. Major funds are determined using a predefined percentage of the assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenue, or expenditure/expenses of either the fund category or the governmental and proprietary funds combined. The nonmajor funds are combined in a single column in the fund financial statements.

Governmental Funds

Governmental funds focus on the sources and uses of funds and provide information on near term inflows, outflows, and balances of available resources. The Authority reports the following governmental funds:

General Fund – The General Fund is the primary operating fund of the Authority. It is used to account for and report all financial resources received and used for those services traditionally provided by a government, except those required to be accounted for and reported in another fund. The General Fund includes transactions for services such as general government.

**PUERTO RICO FISCAL AGENCY AND
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NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2017

In accordance with GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, the classification of fund balance is based on the extent to which the Authority is bound to observe constraints imposed upon the use of resources in the governmental funds. The classifications are as follows:

- *Nonspendable* – amounts that are not in spendable form or are legally or contractually required to be maintained intact.
- *Restricted* – amounts that are legally restricted by outside parties, constitutional provisions, or enabling legislation for a specific purpose.
- *Committed* – amounts that are constrained for specific purposes that are internally imposed by the government's formal action at the highest level of decision making authority and do not lapse at year end.
- *Assigned* – includes fund balance amounts that are constrained by the Authority and are intended to be used for specific purposes that are neither considered restricted or committed.
- *Unassigned* – is the residual classification for the General Fund. In a governmental fund other than the General Fund, a negative amount indicates that the expenditures incurred for a specific purpose exceeded the amounts in the fund that are restricted, committed, and assigned to that purpose.

The Authority has only an unassigned fund balance.

The Authority uses restricted amounts first when both restricted and unrestricted fund balances are available, unless there are legal documents/contracts that prohibit doing this, such as a grant agreement requiring dollar for dollar spending. Additionally, unless required by law or agreement, the Authority would first use committed, then assigned, and lastly unassigned amounts of unrestricted fund balance when expenditures are made.

The Authority does not have a formal minimum fund balance policy.

Measurement Focus and Basis of Accounting

Government-Wide Financial Statements – The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Governmental Fund Financial Statements – The governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available, and net of estimated overpayments (as applicable) and amounts considered not collectible. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period (see note of accounts receivable below for further description of period of availability). Other revenues are considered measurable and available only when cash is received by the Authority.

Expenditures are generally recorded when a liability is incurred, as under accrual basis of accounting.

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A summary reconciliation of the difference between total fund balance as reflected in the governmental funds balance sheet and net position of Governmental Activities as shown on the government-wide statement of net position is presented in an accompanying reconciliation of the balance sheet of governmental funds to the statement of net position.

A summary reconciliation of the difference between net change in fund balance as reflected in the governmental funds statement of revenues, expenditures, and change in fund balance and change in net position in the statement of activities of the governmental-wide financial statements is presented in the accompanying reconciliation of revenues, expenditures, and change in fund balance of governmental funds to the statement of activities.

Accounts Receivable

Accounts receivable are stated net of estimated allowance for uncollectible accounts. The allowance is based on the evaluation of the risk characteristics of the receivable, including past collection experience and current economic conditions. Write-offs are recorded against the allowance when management believes that collectability is unlikely. Recoveries of amounts previously charged off are credited to the allowance. Because of uncertainties inherent in the estimation process, management's estimate may change in the future. The Authority considers revenues available if they are collected within 120 days after the end of the current fiscal year.

Prepaid Expenses

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

Capital Assets

Capital assets include a vehicle. Capital assets are defined by the Authority as assets, which have a cost of \$500 or more at the date of acquisition and have an expected useful life of three or more years. Capital assets are recorded at cost or estimated historical cost. Contributed assets are recorded at estimated fair value at the time received. Depreciation is determined using the straight-line method over the related asset's estimated useful lives. In governmental funds financial statements, capital assets are recorded as expenditures, and no depreciation is recognized. The costs of normal maintenance and repairs that do not add value to the asset or materially extend the asset's useful life are expensed. Generally, estimated useful live of the vehicle is five years.

Deferred Outflows/Inflows of Resources

In addition to assets, the statement of net position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then.

In addition to liabilities, the statement of net position and the governmental fund's balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position and resources that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time.

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Accounting for Pension Costs

Statement No. 68 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Pensions – an amendment of GASB Statement No. 27 (GASB 68) became effective for the year ended June 30, 2015. This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, as well as the requirements of Statement No. 50, Pension Disclosures, as they relate to pensions that are provided through pension plans administered as trusts or equivalent arrangements that meet certain criteria as is the case of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS).

Compensated Absences

Based on the stipulations of the Act 26 of 2017, employees are granted for the accumulation of 1.25 days per month (15 days annually) of vacation. Vacation time accumulated is fully vested by the employees from the first day of work up to a maximum of 60 days. Employees generally accumulate sick leave at a rate of 1.5 days per month up to an annual maximum of 18 days and an accumulated maximum of 90 days. In the event of an employee resignation, it is reimbursed for accumulated vacation days up to the maximum allowed (60 days).

Termination Benefits

The Authority accounts for termination benefits in accordance with GASB Statement No. 47, *Accounting for Termination Benefits*. Pursuant to the provisions of GASB Statement No. 47, in financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for voluntary termination benefits (for example, early retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for involuntary termination benefits (for example, severance benefits) should be recognized in the government-wide financial statements when: (i) a plan of termination has been approved by those with the authority to commit the government to the plan, (ii) the plan has been communicated to the employees, and (iii) the amount can be estimated. In financial statements prepared on the modified accrual basis of accounting, liabilities and expenditures for termination benefits should be recognized to the extent the liabilities are normally expected to be liquidated with expendable available financial resources.

Voluntary Pre-Retirement Program Act

For the period from inception (July 18, 2016) to June 30, 2017, the Authority extended to its employees a new voluntary early retirement program. On December 8, 2015, the Legislature enacted the "Voluntary Pre-Retirement Program Act", (the "Act 211-2015"). Act 211-2015 provides that eligible employees may retire from employment with the Authority in exchange for an early pension and other benefits. Act 211-2015 only applied to employees with twenty years or more participating in the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities ("ERS") created pursuant to Act No. 447 of 1951 and that have not reached 61 years of age.

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The Act 211-2015 provides that the employee will receive an annuity equivalent to 60% of the average compensation, as defined, as of December 31, 2015 and until the participating member attains 61 years of age, which is the age the employee will become part of the ERS. The Authority is responsible for the payment of the employer contribution to the Social Security and Medicare, based on the 60% of the average compensation as of December 31, 2015. The Authority is also responsible for the payment of the related employee and employer contributions to the ERS based on the 100% of average salary as of December 31, 2015, for amounts, which guarantees a 50% minimum compensation to eligible employee of its average compensation as of June 30, 2013. The participating employee will also receive the benefits of health insurance for a period not more than two years, and until he or she reaches 61 years of age.

The number of employees who have voluntarily separated from employment under the provisions of Act 211-2015 were six (6). Payments of such voluntary termination plan are expected to be made through July 2027. The employee annuity for the applicable period were discounted based on the average interest rate of return of unpledged investments.

As of June 30, 2017, the total liability related to these early termination benefits was \$1,880,273.

Risk Management

To minimize its risk of loss, the Authority purchases insurance coverage for public liability, hazard, automobile, crime, and bonding, as well as medical and workmen's insurance for employees. The selection of the insurer has to be approved by the Public Insurance Office of the Puerto Rico Treasury Department. Insurance coverage is updated annually to account for changes in operating risk.

Use of Estimates

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

Accounting Pronouncements Issued But Not Yet Effective

The following new accounting standards have been issued but are not yet effective:

- ***GASB Statement No. 81, Irrevocable Split-Interest Agreements.*** This Statement improves accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. Split-interest agreements are a type of giving agreement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts, or other legally enforceable agreements with characteristics that are equivalent to split-interest agreements, in which a donor transfers resources to an intermediary to hold and administer for the benefit of a government and at least one other beneficiary. Examples of these types of agreements include charitable lead trusts, charitable remainder trusts, and life-interests in real estate. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests. This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. This Statement is not effective until fiscal year 2018.

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- ***GASB Statement No. 83, Certain Asset Retirement Obligations.*** This Statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability based on the guidance in this Statement. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.
- ***GASB Statement No. 84, Fiduciary Activities.*** The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.
- ***GASB Statement No. 85, Omnibus 2017.*** The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits). Specifically, this Statement addresses the measuring of certain money market investments and participating interest earning investment contracts at amortized cost. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.
- ***GASB Statement No. 86, Certain Debt Extinguishment Issues.*** This Statement improves the consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources — resources other than the proceeds of refunding debt — are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged.
- ***GASB Statement No. 87, Leases.*** The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019.

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- ***GASB Statement No. 88, Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements.*** The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.
- ***GASB Statement No. 89, Accounting for Interest Cost Incurred Before the End of a Construction Period.*** This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement. This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund. This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

GASB Statement No. 90, Majority Equity Interests. The primary objectives of this Statement are to improve the consistency and comparability of reporting a government's majority equity interest in a legally separate organization and to improve the relevance of financial statement information for certain components units. It defines a majority equity interest and specifies that a majority equity interest in a legally separate organization should be reported as an investment if a government's holding of the equity interest meets the definition of an investment. The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

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- ***GASB Statement No. 91, Conduit Debt Obligations.*** The primary objectives of this Statement are to provide a single method of reporting conduit debt obligations by issuers and eliminate diversity in practice associated with (i) commitments extended by issuers, (ii) arrangements associated with conduit debt obligations, and (iii) related note disclosures. This Statement achieves those objectives by clarifying the existing definition of a conduit debt obligation; establishing that a conduit debt obligation is not a liability of the issuer; establishing standards for accounting and financial reporting of additional commitments and voluntary commitments extended by issuers and arrangements associated with conduit debt obligations; and improving required note disclosures.

This Statement also addresses arrangements - often characterized as leases - that are associated with conduit debt obligations. In those arrangements, capital assets are constructed or acquired with the proceeds of a conduit debt obligation and used by third-party obligors in the course of their activities. Payments from third-party obligors are intended to cover and coincide with debt service payments. During those arrangements, issuers retain the titles to the capital assets. Those titles may or may not pass to the obligors at the end of the arrangements.

This Statement requires issuers to disclose general information about their conduit debt obligations, organized by type of commitment, including the aggregate outstanding principal amount of the issuers' conduit debt obligations and a description of each type of commitment. The requirements of this Statement are effective for reporting periods beginning after December 15, 2020. Earlier application is encouraged.

Management is evaluating the impact that these Statements will have on the Authority's basic financial statements.

3. GOING CONCERN, UNCERTAINTIES AND LIQUIDITY RISK

Management's evaluation of the Authority's going concern has identified the financial condition of the Commonwealth of Puerto Rico (Commonwealth), the Authority's primary government, as an external matter that may affect the ability of the Authority to continue as a going concern. Following is a brief explanation of the financial difficulties facing the Commonwealth:

The Commonwealth is in the midst of a profound fiscal, economic and liquidity crisis, the culmination of many years of significant governmental deficits, a prolonged economic recession, high unemployment, population decline, and high levels of debt and pension obligations. Further stressing the Commonwealth's liquidity is the vulnerability of revenue streams during times of major economic downturns and large health care, pension and debt service costs. As the Commonwealth's tax base has shrunk and its revenues affected by prevailing economic conditions, health care, pension and debt service costs have become an increasing portion of the General Fund budget, which has resulted in reduced funding available for other essential services. The Commonwealth's high level of debt and unfunded pension liabilities and the resulting required allocation of revenues to service debt and pension obligations contributed to significant budget deficits for several years, which deficits the Commonwealth financed, further increasing the amount of its debt. These matters and the Commonwealth's liquidity constraints, among other factors, adversely affected its credit ratings and its ability to obtain financing at reasonable interest rates, if at all.

Since June 30, 2014, the principal rating agencies have continued to lower their rating on the general obligation bonds of the Commonwealth, which had already been placed in a default rating of "D".

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The Primary Government reflects a net deficit of approximately \$70.3 billion as of June 30, 2016. The Commonwealth's General Fund shows a fund deficit of approximately \$1.2 billion as of June 30, 2016.

These factors have also resulted in delays in the repayment by the Commonwealth and its component units of outstanding GDB lines of credit, which delays have limited GDB's ability to continue providing liquidity to the Commonwealth and have caused GDB to fail to make a principal payment on its debt obligations.

4. CASH AND DEPOSITS PLACED WITH A COMMERCIAL BANK

The table presented below discloses the level of custodial credit risk assumed by the Authority as of June 30, 2017. Custodial credit risk is the risk that in the event of a financial institution's failure, the Authority's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance. All securities pledged as collateral are held by the Secretary of the Treasury of the Commonwealth.

As of June 30, 2017, none of the depository bank balance is uninsured and uncollateralized as follows:

	<u>Carrying Amount</u>	<u>Depository bank balance</u>	<u>Amount uninsured and uncollateralized</u>
Cash	\$ 16,066,951	\$ 16,066,951	\$ -
	<u>\$ 16,066,951</u>	<u>\$ 16,066,951</u>	<u>\$ -</u>

5. ACCOUNTS RECEIVABLE

As of June 30, 2017, the Authority's accounts receivable is composed of the following:

<u>Description</u>	<u>Amount</u>
Puerto Rico Electric Power Authority	\$ 2,259,220
Puerto Rico Aqueduct and Sewer Authority	892,742
Public Building Authority	8,889
Others	12,435
	<u>\$ 3,173,286</u>

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6. CAPITAL ASSETS

Capital assets activity for the period from inception (July 18, 2016) to June 30, 2017, was as follows:

Governmental Activities:

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets:				
Vehicle	\$ -	\$ 53,259	\$ -	\$ 53,259
Total capital assets	<u>-</u>	<u>53,259</u>	<u>-</u>	<u>53,259</u>
Less accumulated depreciation and amortization for:				
Vehicle	-	-	-	-
Total accumulated depreciation and amortization	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total capital assets - net	<u>\$ -</u>	<u>\$ 53,259</u>	<u>\$ -</u>	<u>\$ 53,259</u>

7. COMPENSATED ABSENCES

The activity for compensated absences, included within accounts payable and accrued liabilities, as of June 30, 2017, 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 vacation	\$ -	\$ 344,254	\$ (167,465)	\$ 176,789	\$ 176,789
Accrued sick leaves	-	188,597	(78,072)	110,525	110,525
	<u>\$ -</u>	<u>\$ 532,851</u>	<u>\$ (245,537)</u>	<u>\$ 287,314</u>	<u>\$ 287,314</u>

8. RELATED-PARTY TRANSACTIONS

For the period from inception (July 18, 2016) to June 30, 2017, the Authority entered into the following related party transactions:

- Legislative appropriations of approximately \$38.8 million were received by the governmental funds for the period from inception (July 18, 2016) to June 30, 2017.
- GDB provided administrative services to the Authority at fixed amount of \$100 thousand. As of June 30, 2017, the amount due to GDB amounted to \$373,168.

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9. RETIREMENT SYSTEM

After June 30, 2016, the Commonwealth enacted legislation that changed the structure of pension benefits administered by The Employees' Retirement System of the Government of the Commonwealth of Puerto Rico (ERS).

Plan Description - Prior to August 23, 2017, ERS implemented a cost-sharing, multi-employer defined benefit pension plan administered by the Puerto Rico Government Employees and Judiciary Retirement Systems Administration (ERS and JRS Administration). It is a trust created by 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. ERS began operations on January 1, 1952, at which date, contributions by employers and participating employees commenced. ERS is a pension trust fund of the Commonwealth.

Prior to August 23, 2017, ERS administered different benefit structures pursuant to Act No. 447 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 member's date of hire. Substantially, all full-time employees of the Commonwealth and its instrumentalities were covered by ERS. Membership was mandatory for all regular, appointed, and temporary employees of the Commonwealth 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 ERS were 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 of 2013), in conjunction with other recent funding and design changes, provided for a comprehensive reform to ERS. This summary details the provisions under Act No. 3 of 2013, which were in effect prior to August 23, 2017.

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

- Members of Act No. 447 are generally those members hired before April 1, 1990 (contributory, defined benefit program).
- 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 (contributory, defined benefit program).
- 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 (defined contribution program).

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, became members of the Contributory Hybrid Program as a condition to their employment. In addition, employees who as of June 30, 2013, were participants of previous programs became part of the Contributory Hybrid Program on July 1, 2013.

Each member had a nonforfeitable right to the value of his or her account. Members had three options to invest their contributions. Investment income was credited to the member's account semi-annually. The Commonwealth did not guarantee benefits at retirement age.

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The assets of the defined benefit program, the defined contribution program and the Contributory Hybrid Program were pooled and invested by ERS. Future benefit payments were paid from the same pool of assets.

This summary of ERS plan provisions is intended to describe the essential features of the plan. All eligibility requirements and benefit amounts should be determined in strict accordance with the plan document itself.

Compulsory Retirement

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

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 7% of compensation up to \$6,600 plus 10% of compensation in excess of \$6,600 during the 2014-2015 fiscal year. Members may voluntarily make additional contributions to their hybrid contribution account.

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

Employer Contributions (Article 2 116, as Amended by Law No. 116 of 2010 and Act 3 of 2013) - Prior to July 1, 2011, employer contributions were 9.275% of compensation. Effective July 1, 2011, employer contributions are 10.275% of compensation. For the next four fiscal years, effective July 1, 2012, employer contributions will increase annually by 1% of compensation. For the next five fiscal years, employers contributions will increase annually by 1.25% of compensation, reaching an employer contribution rate of 20.525% of compensation effective July 1, 2020. Under Act No. 106 of 2017, employer's obligations to contribute to ERS were eliminated.

Contributory Hybrid Program

A hybrid plan, such a cash balance plan, (i) determines the benefit amount based on a formula using contributions and earning credits, (ii) has notional individual accounts for members, and (iii) provides lifetime annuity benefits. Prior to August 23, 2017, each member had a defined contribution account that was credited with member contributions and investment yield. Upon retirement, the balance in the account was paid as a lifetime annuity. The program was defined as hybrid because it contained some features that are commonly found in defined benefit (DB) plans and other features that are commonly found in defined contribution (DC) plan.

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Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:

As of June 30, 2017, the Authority does not have a pension liability, expense and deferred outflows and deferred inflows of resources related to pensions since the measure related to GASB 68 was performed 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 June 30, 2015, and these analysis were performed before the Authority began operations on July 18, 2016. Accordingly, these financial statements do not contain any adjustments or required supplementary information required by GASB 68.

10. PUERTO RICO OVERSIGHT, MANAGEMENT AND ECONOMIC STABILITY ACT (PROMESA) AND OTHER LEGISLATION RELATED TO DEBT RESTRUCTURING

As discussed in Note 3, the Commonwealth is in the midst of a profound fiscal economic and liquidity crisis, which have caused, among other things, the initiation of financial measures directed to reinstate fiscal and financial stability, including a number of state and federal laws that have been passed in recent years. As further discussed below, on June 30, 2016 the U.S. Congress enacted PROMESA, which allowed for fiscal and economic discipline including alternatives of debt restructuring. During the fiscal years subsequent to June 30, 2016, the Commonwealth and other governmental entities have initiated restructuring procedures of their existing debt. Following are the most relevant state and federal legislation enacted to address the fiscal crisis and to initiate the economy recovery:

Fiscal Measures Before PROMESA

(i) Retention by the Government of Tax Revenues Conditionally Allocated to Certain Public Corporations and Priority of Payment Provisions

On December 1, 2015, the Governor signed Executive Order No. 46 (Executive Order No. 46). Executive Order No. 46 ordered the Secretary of Treasury to retain certain available resources of the Commonwealth in light of revised revenue estimates for fiscal year 2016 and the Commonwealth's deteriorating liquidity situation. Pursuant to such executive order, the Secretary of Treasury retained revenues conditionally allocated to PRHTA, PRIFA, PRCCDA, and PRMBA for the payment of debt service on their bonds during fiscal year 2016 and segregated such funds for the payment of debt service of the Commonwealth's public debt. Since fiscal year 2017, such revenues are being retained by the Commonwealth for the payment of essential government services pursuant to (a) the Moratorium Act and Act No. 5 (discussed below), and (b) due to the automatic stay under Title III of PROMESA.

(ii) Puerto Rico Emergency Moratorium and Financial Rehabilitation Act, Financial Emergency and Fiscal Responsibility of Puerto Rico Act and Related Executive Orders

On April 6, 2016, the Commonwealth enacted the Moratorium Act. Pursuant to the Moratorium Act, the Governor issued a series of executive orders declaring an emergency period, a moratorium and various other measures with respect to certain obligations of the Commonwealth of Puerto Rico and several of its instrumentalities. Pursuant to those executive orders, certain Commonwealth entities have either: (i) not made debt service payments, (ii) made debt service payments with funds on deposits with the trustees of their bonds, and/or (iii) not received or transferred certain revenues.

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Such executive orders also placed significant restrictions on the disbursement of funds deposited at GDB and suspended the disbursement of loans by GDB.

PROMESA and Other Puerto Rico Legislation

(i) *PROMESA*

In general terms, PROMESA seeks to provide the Commonwealth with fiscal and economic discipline through, among other things: (i) the establishment of the Oversight Board, whose responsibilities include the certification of fiscal plans and budgets for the Commonwealth and its related entities; (ii) a temporary stay of all creditor lawsuits under Title IV of PROMESA; and (iii) two alternative methods to adjust unsustainable debt: (a) a voluntary debt modification process under Title VI of PROMESA, which establishes a largely out-of-court debt restructuring process through which modifications to financial debt can be accepted by a supermajority of creditors; and (b) a quasi-bankruptcy proceeding under Title III of PROMESA, which establishes an in-court debt restructuring process substantially based upon incorporated provisions of Title 11 of the United States Code (U.S. Bankruptcy Code). Each of these elements are divided among PROMESA's seven titles, as briefly discussed below.

(a) *Title 1- Establishment of Oversight Board and Administrative Matters*

Upon PROMESA's enactment, the Oversight Board was established for Puerto Rico. As stated in PROMESA, "the purpose of the Oversight Board is to provide a method for a covered territory to achieve fiscal responsibility and access to the capital markets." On August 31, 2016, the President of the United States announced the appointment of the Oversight Board members. Each Oversight Board member is required to have "knowledge and expertise in finance, municipal bond markets, management, law, or the organization or operation of business or government." The Oversight Board was "created as an entity within the territorial government for which it was established" and is expressly not an entity of the federal government, but it was also established to act independently from the Commonwealth government, such that neither the Governor nor the Legislature may: (i) exercise any control, supervision, oversight, or review over the Oversight Board or its activities; or (ii) enact, implement, or enforce any statute, resolution, policy, or rule that would impair or defeat the purpose of PROMESA, as determined by the Oversight Board.

(b) *Title II- Fiscal Plan and Budget Certification Process and Compliance*

Title II sets forth the requirements for proposing and certifying fiscal plans and budgets for the Commonwealth and its instrumentalities. Each fiscal plan serves as the cornerstone for structural reforms the Oversight Board deems necessary to ensure the territory, or instrumentality, will be on a path towards fiscal responsibility and access to capital markets. According to the legislative history, a fiscal plan should "provide for a sustainable level of debt, improve governance, and provide for capital expenditures that promise economic growth, and respect the relative priorities that different classes of bondholders have vis-à-vis one another under Puerto Rico law."

Only after the Oversight Board has certified a fiscal plan may the Governor submit a fiscal year Commonwealth budget and fiscal year budgets for certain Commonwealth instrumentalities (as approved by the Oversight Board) to the Legislature.

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In furtherance of the foregoing duties, PROMESA contains a provision that grants the Oversight Board powers to monitor compliance with certified fiscal plans and budgets and undertake certain actions, including spending reductions and the submission of recommended actions to the Governor that promote budgetary compliance. Please refer to the language of PROMESA for a complete description of the Oversight Board's powers related to fiscal plan and budgetary compliance.

(c) Title III- In- Court Restructuring Process

Title III of PROMESA establishes an in-court process for restructuring the debts of Puerto Rico and other United States territories that is modeled after the process under Chapter 9 of the U.S. Bankruptcy Court.

The Oversight Board has sole authority to file a voluntary petition seeking protection under Title III of PROMESA.

In a Title III case, the Oversight Board act as the debtor's representative and is authorized to take any actions necessary to prosecute the Title III case. Immediately upon filing the Title III petition, Bankruptcy Code section 362 (which is incorporated into Title III cases under PROMESA) applies to automatically stay substantially all litigation against the debtor (the Title III Stay). A Title III case culminates in the confirmation of a plan of adjustment of the debts of the debtor. The Oversight Board has the exclusive authority to file and modify a plan of adjustment prior to confirmation.

(d) Title IV- Temporary Stay of Litigation, Government Reporting, and Other Miscellaneous Provisions

Title IV of PROMESA contains several miscellaneous provisions, including a temporary stay of litigation related to "Liability Claims," relief from certain wage and hours laws, the establishment of a Congressional Task Force on Economic Growth in Puerto Rico (the Task Force), the requirement that the Comptroller General of the United States submit two reports to Congress regarding the public debt levels of the U.S. territories, and expansion of the federal government's small business HUBZone program in Puerto Rico.

Pursuant to PROMESA section 405, the enactment of PROMESA immediately and automatically imposed a temporary stay (the Title IV Stay) from June 30, 2016 (the date of PROMESA's enactment) through February 15, 2017 of all "Liability Claim" litigation commenced against the Commonwealth of Puerto Rico and its instrumentalities after December 18, 2015. A "Liability Claim" is defined as any right to payment or equitable remedy for breach of performance related to "a bond, loan, letter of credit, other borrowing title, obligation of insurance, or other financial indebtedness for borrowed money, including rights, entitlements, or obligations whether such rights entitlements, or obligations arise from contract, statute, or any other source of law related [thereto]" for which the Commonwealth or one of its instrumentalities was the issuer, obligor, or guarantor and such liabilities were incurred prior to June 30, 2016. The Title IV Stay was subject to a one-time 75-day extension by the Oversight Board or a one-time 60-day extension by the United States District Court. On January 28, 2017, the Oversight Board extended the Title IV Stay by 75 days to May 1, 2017, at which time the Title IV Stay expired.

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Title IV of PROMESA also required several federal government reports. First, PROMESA established the Task Force within the legislative branch of the U.S. federal government. The Task Force submitted its report to Congress on December 20, 2016.

Second, PROMESA required the U.S. Comptroller General, through the Government Accountability Office (GAO), to submit a report to the House and Senate by December 30, 2017 regarding: (i) the conditions that led to Puerto Rico's current level of debt; (ii) how government actions improved or impaired its financial condition; and (iii) recommendations on new fiscal actions or policies that the Commonwealth could adopt. The GAO published this report on May 9, 2018.

Third, PROMESA required the U.S. Comptroller General, through the GAO, to submit to Congress by June 30, 2017 a report on public debt of the U.S. territories. In addition to its initial report, the GAO must submit to Congress updated reports on the public debt at least once every two years. The GAO published this report on October 2, 2017.

(e) Title V- Infrastructure Revitalization

Title V of PROMESA established the position of Revitalization Coordinator under the Oversight Board and provides a framework for infrastructure revitalization through an expedited permitting process for "critical projects" as identified by the Revitalization Coordinator.

(f) Title VI- Consensual, Out-of-Court Debt Modification Process

Title VI of PROMESA establishes an out-of-court process for modifying Puerto Rico's debts. Under PROMESA section 601(d), the Oversight Board is authorized to establish "pools" of bonds issued by each Puerto Rico government-related issuer based upon relative priorities. After establishing the pools, the government issuer or any bondholder or bondholder group may propose a modification to one or more series of the government issuer's bonds. If a voluntary agreement exists, the Oversight Board must issue a certification and execute a number of additional processes in order to qualify the modification.

Finally, the United States District Court for the District of Puerto Rico must enter an order approving the Qualifying Modification and vesting in the issuer all property free and clear of claims in respect of any bonds.

The Title VI process was successfully implemented to restructure the debts of the GDB. The GDB Title VI process is discussed below under Component Units- GDB, Qualifying Modification and Title VI Approval Process.

(g) Title VII- Sense of Congress

Title VII of PROMESA sets forth the sense of Congress that "any durable solution for Puerto Rico's fiscal and economic crisis should include permanent, pro-growth fiscal reforms that feature, among other elements, a free flow of capital between possessions of the United States and the rest of the United States."

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(ii) *Puerto Rico Legislation and Other Fiscal Measures*

Act No. 2 of January 18, 2017 (Act No. 2 of 2017), Puerto Rico Fiscal Agency and Financial Advisory Authority Act, was enacted to expand the Authority's power and authority (as initially established under the Moratorium Act) so that the Authority has the sole responsibility to negotiate, restructure, and reach agreements with creditors on all or part of the public debt or any other debt issued by any Commonwealth entity. The Authority is also responsible for the collaboration, communication, and cooperation efforts between the Commonwealth and the Oversight Board under PROMESA. In addition, Act No. 2 of 2017 established the Authority as the Commonwealth entity responsible for carrying out the roles inherited from the GDB along with additional duties and powers, which include, among other things: (i) oversight of the Commonwealth budget; (ii) an administrative presence on every board or committee where the GDB president is currently a member; (iii) authority to conduct audits and investigations; and (iv) authority to freeze budgetary items, appoint trustees, redistribute human resources, and change procedures.

Act No. 3 of January 23, 2017 (Act No. 3 of 2017), the Fiscal Crisis Management Act, was enacted to extend most of the fiscal measures that had been adopted under Act No. 66 of 2014 through July 1, 2021, including a 10-year extension of the excise tax on acquisitions by foreign corporations under Act No. 154.

Act No. 5 of January 29, 2017 (Act No. 5 of 2017), the Puerto Rico Fiscal Responsibility and Financial Emergency Act, was enacted to maintain the moratorium on debt payment existing under the Moratorium Act; however, it allowed the Commonwealth to segregate funds that would eventually be used to fund the payment of public debt. Act No. 5 of 2017 states that the Governor may pay debt service as long as the Commonwealth is able to continue to fund essential services, such as the health, safety, and wellbeing of the people of Puerto Rico, including providing for their education and assistance to residents. Act No. 5 of 2017 continued to declare the Commonwealth to be in state of emergency and increased the Governor's powers to manage the Commonwealth's finances. The emergency period under Act No. 5 of 2017 was set to expire on May 1, 2017 to coincide with the expiration of the Title IV Stay (as discussed above), unless extended by an additional three months by executive order. On April 30, 2017, the Governor issued executive order OE2017031, which extended the Act No. 5 of 2017 emergency period to August 1, 2017. On July 19, 2017, the Legislature enacted Act No. 46 of 2017 (Act No. 46 of 2017), which further extended the Act No. 5 of 2017 emergency period through December 31, 2017. Act No. 46 of 2017 allowed the Governor to sign executive orders to extend the emergency period for successive periods of six months as long as the Oversight Board remains established for Puerto Rico under PROMESA. On December 27, 2018, the Governor issued executive order EO-2018-053 extending the emergency period until June 30, 2019.

Act No. 106 of August 23, 2017 (Act No. 106 of 2017), the Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants, reformed the Commonwealth's pensions by replacing the governing boards of the Retirement Systems with a single Retirement Board of the Commonwealth of Puerto Rico (Retirement Board) and established a separate "Account for the Payment of Accrued Pensions" to implement a PayGo method for the Retirement Systems. Act No. 106 of 2017 created the legal framework so that the Commonwealth can guarantee payments to pensioners through the PayGo system.

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Act No. 109 of August 24, 2017 (Act No. 109 of 2017), the Government Development Bank for Puerto Rico Debt Restructuring Act (the GDB Restructuring Act), effectuated the GDB Fiscal Plan and provided a path for the implementation of the GDB RSA by addressing the claims of the Commonwealth and its instrumentalities against GDB. Act No. 109 of 2017 created two special purpose entities- the GDB Debt Recovery Authority and the Public Entity Trust- into which the GDB would divide and irrevocably transfer its assets. As discussed below, these entities were utilized to complete the transactions in the GDB's Qualifying Modification, as approved by the District Court under Title VI of PROMESA.

Act No. 241 of November 15, 2018 (Act No. 241 of 2018), the Puerto Rico Sales Tax Financing Corporation Act, amended and restated Act No. 91 of 2006 to establish the legal framework for the restructuring of COFINA's issued and outstanding bonds by, other things, authorizing the issuance of new COFINA bonds necessary to complete the transactions contemplated under COFINA's Third Amended Plan of Adjustment, as discussed below.

PROMESA Title III Cases

(i) Oversight Board Commencement of Title III Cases

On May 1, 2017, the Title IV Stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its instrumentalities to resume. On May 3, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for the Commonwealth by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico (the Title III Court). On May 5, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for COFINA by filing a similar petition for relief under Title III of PROMESA in the Title III Court.

On May 21, 2017, the Oversight Board, at the request of the Governor, commenced Title III cases for PRHTA and ERS by filing similar petitions for relief under Title III of PROMESA in the Title III Court. On July 2, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for PREPA by filing a similar petition for relief under Title III of PROMESA in the Title III Court. All of the foregoing Title III cases have been consolidated for procedural purposes only and are being jointly administered under Case No. 17-3283-LTS in the United States District Court for the District of Puerto Rico.

The Title III cases were commenced in part due to the May 1, 2017 expiration of the Title IV Stay. Title III of PROMESA incorporates the automatic stay provisions of Bankruptcy Code section 362 and 922, which are made applicable to the Title III cases pursuant to PROMESA section 301(a). Accordingly, upon the filing of the Title III cases, the Title III Stay immediately went into effect to stay creditor litigation. All claims against any Title III debtor that arose prior to the filing of the Title III case (whether or not discussed herein) may be subject to the laws governing Title III.

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On August 7, 2017, a group of GO bondholders led by Aurelius Investment, LLC, Aurelius Opportunities Fund, LLC, and Lex Claims, LLC (collectively, Aurelius) filed a motion to dismiss the Title III petitions. In the motion, Aurelius argued that the appointment of the Oversight Board members violated the "Appointments Clause" of the United States Constitution, which requires that "principal officers" of the United States be appointed by the President and confirmed by the Senate. The Title III Court denied Aurelius' motion to dismiss, and Aurelius appealed to the United States Court of Appeals for the First Circuit. On February 15, 2019, the First Circuit reversed the Title III Court, holding that the Oversight Board members' appointment process violated the Appointments Clause. The First Circuit stayed its ruling for 90 days to allow the President and the Senate to appoint the Oversight Board in accordance with the United States Constitution. It also expressly validated all of the Oversight Board's past actions, including any actions taken by the Oversight Board during the 90-day stay period. The Oversight Board has announced its intention to appeal the First Circuit's decision to the Supreme Court. Although the First Circuit stayed its ruling for 90 days, the continued prosecution of the Title III cases may be uncertain if the Oversight Board is not properly re-appointed during the 90-day stay period, unless such stay is extended.

(ii) *Mediation in the Title III Cases*

On June 23, 2017, the Title III Court appointed a team of five federal judges to facilitate settlement negotiations of any and all issues and proceedings arising in the Title III cases. Mediation of various disputes relating to Title III cases remains ongoing.

(iii) *Commonwealth Title III Case*

On May 5, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for COFINA by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico. The deadline by which all creditors were required to file their proofs of claim against COFINA was June 29, 2018.

After the commencement of the Commonwealth's Title III case, numerous motions and adversary proceedings have been filed both by and against the Commonwealth regarding creditors rights to Commonwealth assets. The outcome of these proceedings and their impact on any plan of adjustment for the Commonwealth cannot be determined at this time.

(iv) *COFINA Title III Case*

On May 5, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for COFINA by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico.

After extensive legal proceedings, on August 29, 2018, COFINA, the Authority, the Oversight Board and various holders and insurers of COFINA's bonds (the Settlement Parties) entered into that certain Plan Support Agreement dated as of August 29, 2018 (the Original PSA), that contemplates, among other things, (i) the compromise and settlement of the Commonwealth-COFINA Dispute, consistent with the Agreement in Principle, providing COFINA with an ownership interest in an amount up to 53.65% of the Pledged Sales Tax Base Amount; and (ii) the Title III Court's approval of the compromise and settlement concurrently through a plan of adjustment in COFINA's Title III case and a settlement motion in the Commonwealth's Title III case.

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On November 7 and 8, 2018, respectively, new legislation to amend and restate Act 91 of 2006 to establish the legal framework for the restructuring of COFINA's issued and outstanding bonds was passed in the Puerto Rico House of Representatives and the Puerto Rico Senate. On November 15, 2018, the Governor of Puerto Rico signed into law the new legislation as Act No. 241 of 2018.

(v) *PRHTA Title III Case*

On May 21, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for PRHTA by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico. The deadline by which all creditors were required to file their proofs of claim against PRHTA was June 29, 2018.

After the commencement of PRHTA's Title III case, numerous motions and adversary proceedings have been filed both by and against PRHTA regarding creditors rights to PRHTA assets. The outcome of these proceedings and their impact on any plan of adjustment for PRHTA cannot be determined at this time.

(vi) *ERS Title III Case*

The Title IV Stay expired on May 1, 2017. On May 21, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for ERS by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico. The deadline by which all creditors were required to file their proofs of claim against ERS was June 29, 2018.

After the commencement of ERS's Title III case, numerous motions and adversary proceedings have been filed both by and against ERS regarding creditors rights to ERS assets. The outcome of these proceedings and their impact on any plan of adjustment for ERS cannot be determined at this time.

(vii) *PREPA Title III Case*

On July 2, 2017, the Oversight Board, at the request of the Governor, commenced a Title III case for PREPA by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico.

(viii) *GDB Qualifying Modification and Title VI Approval Process*

On November 29, 2018, GDB completed a restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA (the Qualifying Modification). Under the Qualifying Modification, holders of certain bond and deposit claims against GDB exchanged their claims for bonds issued by a newly created public instrumentality- the GDB Debt Recovery Authority- and GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. In addition, pursuant to the GDB Restructuring Act, claims on account of deposits held by the Commonwealth and other public entities were exchanged for interest in a newly formed trust created pursuant to the GDB Restructuring Act, titled the Public Entity Trust (the PET).

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Under the GDB Restructuring Act, the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates, including the Authority (each a Non-Municipal Government Entity) and GDB were determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to GDB or of any bond or note of such Non-Municipal Government Entity held by GDB as of such date. Those Non-Municipal Government Entities having net claims against GDB, after giving effect to the foregoing adjustment received their pro rata share of interests in the PET, which was deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against GDB.

The assets of the PET (the PET Assets) consist of among other items, a claim against the Commonwealth totaling no more than \$905 million, which is the subject of a proof of claim filed in the Commonwealth case pending under Title III of PROMESA. The Authority's recovery on account of its interest in the PET will depend upon the recovery ultimately received by the PET on account of the PET Assets. Claims that the Commonwealth and other governmental entities may have had against GDB have been released pursuant to the Qualifying Modification (except for as set forth there in), and GDB has reduced the amount of any allowed claim against the Commonwealth it may receive as set forth in such Qualifying Modification.

On November 6, 2018, the District Court approved GDB's Qualifying Modification under Title VI of PROMESA and the Qualifying Modification became effective as of November 29, 2018.

(ix) *PRIFA- Ports Restructuring Support Agreement*

On April 10, 2019, the Authority, on behalf of PRIFA and PRPA, entered into a restructuring support agreement ("RSA") with the Ad Hoc Group of holders of certain Series 2011 bonds issued by PRIFA (the "PRIFA-Ports Bonds"). The restructuring contemplated by the RSA has two principal components. First, the members of the Ad Hoc Group- who hold more than 90% of the outstanding PRIFA-Ports Bonds- will tender all of their holding of PRIFA-Ports Bonds for their pro rata share of (i) the distribution made to PRIFA under the Third Amended Title III Plan of Adjustment of Puerto Rico Sales Tax Financing Corporation on account of \$91.5 million of Junior COFINA Bond Claims (as defined in the COFINA plan) held by PRIFA; and (ii) a \$40 million promissory note issued by PRPA. Second, the Puerto Nuevo cargo and logistics operation in the San Juan Bay (the "Property") will be revitalized through the Ad Hoc Group's contribution to a newly formed subsidiary of PRPA of (i) at least \$11 million, (ii) the promissory note, and (iii) up to 10% of gross rental income generated from the Property. In exchange, AFICA will issue new bonds to the Ad Hoc Group in a face amount equal to the projected cash flow of the Property.

The proposed transaction remains subject to approval from the Financial Oversight and Management Board for Puerto Rico and agreement on other definitive documentation.

Default of Bond Principal and Interest Payments

As a direct result of the Moratorium Act and the retention of certain revenues conditionally allocated to public corporations and priority of payment provisions, the Commonwealth and such public corporations have not been able to make the debt service payments as they become due.

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11. SUBSEQUENT EVENTS

Subsequent events were evaluated through September 6, 2019, the date the basic financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the 2017 basic financial statements. The subsequent events disclosed below are principally those related to debt activities at the Commonwealth level, including credit rating downgrade events, other revenue and/or budget related matters and fiscal events and related legislation, both local or federal, that management believes are of public interest for disclosure.

Primary Government

Debt Investigation Report

On August 2, 2017, the Oversight Board announced its intention, pursuant to its authority under PROMESA, to conduct an investigation to review the fiscal crisis and its contributors, and examine Puerto Rico's debt and its issuance, including disclosure and selling practices. To that end, the Oversight Board named a special investigation committee (the Special Investigation Committee) and conducted a competitive process to identify and select an independent firm to conduct the investigation. On September 13, 2017, the Oversight Board announced that the Special Investigation Committee retained an independent investigator to carry out a review of the Commonwealth's debt and its connection to the current financial crisis. The Special Investigation Committee considers this investigation an integral part of the Oversight Board's mission to restore the fiscal balance and economic opportunity and to promote the Commonwealth's reentry to the capital markets. The independent investigator's work concluded, and the Oversight Board published the independent investigator's final report on August 20, 2018 (the Debt Investigation Report). The Debt Investigation Report provides an analysis of the historical and more recent macroeconomic and political factors contributing directly and indirectly to the Commonwealth's fiscal and economic crisis, the Commonwealth's municipal bond issuance process, and legislative efforts to restructure the debt, as well as the Oversight's Board investigative findings, policy recommendations, and identification of potential claims and matters for regulatory attention.

The Debt Investigation Report presented findings and recommendations on the following areas:

- GDB
- Puerto Rico Public Utilities (PREPA and PRASA)
- COFINA
- ERS
- Puerto Rico's Budgeting, External Reporting, and Accounting Functions
- Calculation of the Constitutional Debt Limit
- Credit Rating Agencies (CRAs)
- Selling Practices for Puerto Rico-Related Bonds
- Puerto Rico's Government Ethics Framework
- Issuers' Use of Interest Rate Swaps

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- Puerto Rico's Lack of a Clear Mechanism for Validating Puerto Rico-Related Bonds Before They Issue
- Possession Tax Credit

Finally, the independent investigator presented an overview of potential causes of action. The Debt Investigation Report in its entirety can be found on the Oversight Board's website.

On August 28, 2018, the Oversight Board appointed its Special Claims Committee and delegated to the Special Claims Committee any and all authority of the Oversight Board to review the findings in the Debt Investigation Report and to take any appropriate steps, including, but not limited to, recommending and/or initiating the negotiation and/or prosecution of claims based on the findings in the Debt Investigation Report on behalf of the Title III debtors for the benefit of all creditors and parties in interest in the Title III cases. The Special Claims Committee is entitled, in its full discretion, to determine the scope of any further action, but not limited to, additional investigation, as well as claims to be pursued, and to retain such advisors, consultants, attorneys or other advisors as it in its sole discretion sees fit. On October 25, 2018, the Oversight Board requested proposals for counsel to assist the Special Claims Committee regarding consideration of potential claims described in the Debt Investigation Report. On November 28, 2018, the Special Claims Committee signed the contract with the firm that will provide those services. The Commonwealth is cooperating with this investigation.

On January 14, 2019, the Special Claims Committee and the Creditors' Committee filed a joint omnibus objection (the GO Claims Objection) seeking the disallowance of more than \$6 billion of claims related to the Commonwealth's GO bonds issued on or after March 2012, including (a) \$2.3 billion in Public Improvement Refunding Bonds, Series 2012 A issued in April 2012; (b) \$415.27 million in Public Improvement Refunding Bonds, Series 2012 B issued in March 2012; and (c) \$3.5 billion in General Obligation bonds of 2014, Series A issued in March 2014 (collectively, the Challenged GO Bonds). According to the GO Claims Objection, the Challenged GO Bonds are "invalid" because, among other things, they were issued in violation of: (i) the Commonwealth Constitution's debt service limit, which should have included debt service on bonds issued by the PBA that the GO Claims Objection characterizes as a "sham" structure; (ii) the Commonwealth's constitutional balanced budget clause, which should have included \$425 million of interest that was excluded; and (iii) the Commonwealth's constitutional balanced budget clause because proceeds of the Challenged GO Bonds were used to finance deficit spending. On February 15, 2019, the Title III Court entered a procedures order related to the GO Claims Objection, which gives parties until April 16, 2019 to provide notice of their participation in the proceedings related to the GO Claims Objection.

This matter is on going and the Commonwealth cannot predict when it will be concluded or its outcome.

Commonwealth Retirements Systems

The Commonwealth has historically maintained three retirement systems: (i) ERS; (ii) JRS; and (iii) TRS (collectively, the Retirement Systems).

On June 23, 2017, the Legislature approved certain other assignments for the Fiscal Year 2018 Joint Resolution, which among other things, ordered ERS, JRS and TRS to liquidate their assets and pass the net proceeds to the Treasury Department. On July 20, 2017, ERS, JRS and TRS sold investments amounting to approximately \$297 million.

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On June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 in order to convey to the Primary Government's agencies, public corporations and municipalities the new implementation procedures to adopt, effective, July 1, 2017, the new "pay-as-you-go (PayGo)" mechanism for all of the Commonwealth's Retirement Systems. With the start of the fiscal year 2018, employer's contributions, contributions ordered by special laws and the Additional Uniform Contribution were all eliminated and replaced by a monthly PayGo charge that will be collected from the aforementioned government entities to pay retirees. The Retirement Systems will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality. The PayGo charge must be submitted to the Treasury Department before the 15th day of each month along with the individual contributions withheld from active employees. As liquid retirement funds become depleted, the PayGo charge is expected to increase.

In addition to the establishment of the PayGo mechanism, on August 23, 2017, the Governor signed into law Act No. 106 of 2017, which reformed the Retirement Systems, so that their active participants would deposit their individual contributions in a new Defined Contribution Plan that will be managed by a private entity. Act No. 106 of 2017, creates the legal framework so that the Commonwealth can guarantee payments to pensioners through the PayGo system. Under the PayGo system, the Commonwealth makes pension payments from the General Fund, to the extent money is available, and municipalities and public corporations will reimburse the Commonwealth for any payments made on behalf of their employees. Approximately \$2 billion was allocated for these purposes in the fiscal year 2018 budget. Act No. 106 of 2017 also created a Defined Contribution Plan, similar to a 401(k) plan, which guarantees the contributions of public servants, because future benefits will not be paid by the Retirement Systems.

On March 12, 2019, the Creditors' Committee filed the ERS Bond Claim Objection seeking to disallow all claims asserted against ERS based on the approximately \$3.1 billion of outstanding bonds issued by ERS in 2008.

Aftermath of Hurricane Maria

On September 20, 2017, Puerto Rico was directly impacted by Hurricane Maria, leaving in its path the destruction of thousands of homes, knocking out power across the entire island and flooding many streets and roads. As a result of the massive impact of the hurricane, a series of actions and events have been taken. Some of these actions, events and considerations taken are being covered in the ensuing paragraphs.

On September 20, 2017, the same day that Hurricane Maria made landfall in Puerto Rico, the Governor requested funds from categories A and B of FEMA's public assistance program to address the state of emergency, which were immediately approved. Shortly thereafter, the Governor requested funds from categories C through G of FEMA's public assistance program, which are the categories dealing with permanent infrastructure projects such as roads, bridges, electricity and water infrastructure, public buildings, and parks and recreation spaces.

After FEMA's processing of the categories C through G funding requests, on November 1, 2017, the U.S. President approved the use of such funds for permanent projects. By doing so, the federal share on these funds was also increased from 75% to 90%, given the major disaster caused by the Hurricane Maria in Puerto Rico.

On September 21, 2017, pursuant to its authority under PROMESA and section 3 of the fiscal year 2018 budget resolutions, the Oversight Board announced its approval for the Commonwealth to reallocate up to \$1 billion of its fiscal year 2018 budget to be used for emergency funding in the aftermath of Hurricane Maria.

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On October 23, 2017, the Governor issued executive order EO 2017 065, creating the Central Recovery and Reconstruction Office of Puerto Rico (CRRO) pursuant to Act No. 211 of 1999, Act No. 5 of 2017, and Act No. 20 of 2017. The CRRO is created as a division within the Public Private Partnership Authority (P3 Authority) for the purpose of (i) identifying, procuring, and administering resources to invest in the recovery of Puerto Rico, (ii) coordinating and channeling efforts of the Commonwealth related to the recovery of Puerto Rico, (iii) financing, executing, or effecting works and infrastructure projects related to the recovery of Puerto Rico, and (iv) advising the Governor and providing technical assistance and advice to other governmental entities regarding any matter related to the recovery of Puerto Rico. On November 10, 2017, the Governor issued executive order EO 2017 069, which amended EO 2017 065.

On October 26, 2017, the U.S. President signed into law the Additional Supplemental Appropriations for Disaster Relief Requirements Act of 2017, which provides for \$36.5 billion of disaster relief funds for Texas, Florida, Puerto Rico and the United States Virgin Islands (USVI) related to damage from Hurricanes Harvey, Irma, and Maria. The law included \$4.9 billion of Disaster Assistance Direct Loans to maintain liquidity for Puerto Rico and the USVI. Puerto Rico is expected to receive a substantial majority of these loans, with the USVI expected to receive only between \$200 million and \$400 million.

On November 8, 2017, the Governor issued executive order EO 2017 066 pursuant to his authority under Act No. 5 of 2017. EO 2017 066 delegates the Governor's receivership powers under Section 206(a) of Act No. 5 of 2017 to the Authority so that it may act as receiver of PREPA's procurement division and any other division or office whose duties affect PREPA'S procurement processes for goods and services in order to supervise and reform the procurement processes. EO 2017 066 also created within PREPA the Office of Contract and Procurement Compliance, which reports to the Authority.

On November 8, 2017, the Governor also issued executive order EO 2017 068, which established a 10% reimbursement for the certain small and mid-sized business on their sales and use tax filings from August 2017 through November 2017.

On November 27, 2017, the Governor announced a series of controls that will be imposed in the administration of federal funds for the long-term infrastructure projects required in the aftermath of Hurricanes Irma and Maria, and which the Commonwealth expects to reach the \$94.4 billion the Governor requested on November 14, 2017 to the U.S. Congress. In addition to the creation of the CRRO previously discussed, another control measure would be the role that will be played by FEMA. In addition to the oversight over the use of federal money, FEMA will preauthorize each permanent work project so that prior to its start, the Commonwealth can be sure that it will receive federal funds to help pay for it. For long-term infrastructure reconstruction projects, the Commonwealth will use section 428 of the Stafford Act, which provides some flexibility in the requirements for obtaining the maximum amount of federal funds for these efforts. For example, under that section, introduced after Superstorm Sandy, the state government is not required to reconstruct exactly to the pre-disaster state, as required by FEMA's process under section 406. In essence, section 428 would allow the Commonwealth to make improvements to existing infrastructure without losing access to the maximum amount of federal funds it could obtain via reimbursement. Currently, the United States federal government will cover up to 90% of the cost of permanent work projects, while the rest must come from the local government's checkbook. Under section 428, both the Commonwealth and FEMA will analyze the damage separately and, if there is any disagreement, a third party would validate a single damage estimate. Without these evaluations, FEMA will not be able to disburse funds to pay for the respective project.

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On February 9, 2018, the U.S. Congress approved, and the U.S. President signed an amendment of the Continuing Appropriation Act of 2018 to provide continuing fiscal year 2018 appropriations to most federal agencies through March 23, 2018. The Continuing Appropriations Act allocates additional budget appropriations of approximately \$15 billion to the U.S. Corps of Engineers for necessary expenses to address emergency situation projects, and to construct, and rehabilitate and repair damages caused by natural disasters. Of the total amount of \$15 billion, not less than \$10.4 billion will be available for such projects within states and insular areas that were impacted by Hurricanes Harvey, Irma, and Maria and all repair, rehabilitation, study, design, and construction of the U.S. Corps of Engineers projects in Puerto Rico and the USVI will be conducted at full federal expense. Also, allocates approximately \$28 billion to the Community Development Fund to cover the necessary expenses related to disaster relief, long-term recovery, restoration of infrastructure and housing, economic revitalization, and mitigation in the most impacted and distressed areas resulting from a major declared disaster that occurred in 2017; of the amounts made available under this provision, no less than \$11 billion will be allocated to the States and units of local government affected by Hurricane Maria, and of such amounts allocated to such grantees affected by Hurricane Maria, \$2 billion will be used to provide enhanced or improved electrical power systems. In addition, the budget appropriation include \$4.8 billion in Medicaid funds for Puerto Rico, \$39 million to carry out U.S. Customs and border Protection activities in fiscal year 2018 in Puerto Rico and the USVI, \$30.9 million for construction, rehabilitation and acquisition for Job Corps Centers in Puerto Rico, \$64 million to repair the U.S. Immigration & Customs Enforcement Service (ICE) facilities in Puerto Rico, USVI, Texas and Florida, \$1.37 billion for the Emergency Recovery Program of the Federal Highway Administration of which Puerto Rico will receive 100 percent federal contribution to repair damages from Hurricanes Irma and Maria, \$14 million for the Special Supplemental Nutrition Program for Women, Infants, and Children (known as PAN in Spanish) for infrastructure grants to Puerto Rico and the U.S. Virgin Islands to assist in the repair and restoration of buildings, equipment, technology, and other infrastructure damaged as a consequence of Hurricanes Irma and Maria and \$24 million for the Commodity Assistance Program for the emergency food assistance program to cover necessary expenses related to the consequences of Hurricanes Harvey, Irma, and Maria or due to wildfires in 2017.