

AUDITED FINANCIAL STATEMENT
OFFICE OF GOVERNMENT ETHICS OF THE
COMMONWEALTH OF PUERTO RICO

(A Component Unit of the Commonwealth of Puerto Rico)

Basic Financial Statements and Required
Supplementary Information as of and
for the year ended June 30, 2014
and Independent Auditors' Report

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

FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014

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Francisco J. Perdomo CPA | José Soila CPA | Carlos R. Velez CPA

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INTERNATIONAL

INDEPENDENT AUDITORS' REPORT

Mrs. Zulma R. Rosario, Executive Director
Office of Government Ethics of the Commonwealth of Puerto Rico
(A Component Unit of the Commonwealth of Puerto Rico)
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities and each major fund of the Office of Government Ethics of the Commonwealth of Puerto Rico (a component unit of the Commonwealth of Puerto Rico), as of and for the year ended June 30, 2014, which collectively comprise the Office's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal 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 opinions 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.

Auditor's Responsibility - Cont'

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence 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 respective financial position of the governmental activities and each major fund of the Office of Government Ethics of the Commonwealth of Puerto Rico (a component unit of the Commonwealth of Puerto Rico) as of June 30, 2014 and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.



Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the *management's discussion and analysis and budgetary comparison information on pages 4 to 7 and 25* 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.

March 30, 2015

Stamp E156837 of the P.R.
Society of Certified Public
Accountants has been affixed
to the file copy of this report.

PSV + G RSC



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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

This section presents a narrative overview of the financial performance of Office of Government Ethics of the Commonwealth of Puerto Rico (the "Office") as of and for the year ended June 30, 2014. The information presented here should be read in conjunction with the Office's basic financial statements, including the notes thereto.

FINANCIAL HIGHLIGHTS

- Net assets of the Office increase \$890 thousand, from \$5.26 million as of June 30, 2013 to \$6.15 million as of June 30, 2014.
- Capital expenditures made during 2014 amounted to \$661 thousand.

OVERVIEW OF THE FINANCIAL STATEMENTS

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

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

FUND FINANCIAL STATEMENTS

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

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

FINANCIAL ANALYSIS OF THE OFFICE AS A WHOLE

We provide the readers of these basic financial statements with the following summarized discussion and analysis of the relevant facts that affected the government-wide financial statements as of June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>	<u>Change</u>	<u>Percentage</u>
Assets:				
Cash	\$ 5,721,315	\$ 4,578,632	\$ 1,142,683	19.97%
Certificate of deposit	250,227	250,443	(216)	(0.09%)
Account receivable	1,073	1,404	(331)	(30.85%)
Prepaid expense	11,021	8,368	2,653	24.07%
Deferred financing cost	46,947	54,153	(7,206)	(15.35%)
Capital assets:				
Non depreciable	2,000,000	2,000,000	-	0.00%
Depreciable - net	7,613,430	7,594,554	18,876	0.25%
Total assets	<u>\$ 15,644,013</u>	<u>\$ 14,487,554</u>	<u>\$ 1,156,459</u>	<u>7.39%</u>
Liabilities:				
Current liabilities	\$ 1,535,184	\$ 1,169,325	\$ 365,859	23.83%
Non-current liabilities	7,962,390	8,055,214	(92,824)	(1.17%)
Total liabilities	<u>9,497,574</u>	<u>9,224,539</u>	<u>273,035</u>	<u>(0.54%)</u>
Net assets:				
Invested in capital assets	2,639,463	2,042,160	597,303	22.63%
Unrestricted	3,506,976	3,220,855	286,121	8.16%
Total net assets	<u>6,146,439</u>	<u>5,263,015</u>	<u>883,424</u>	<u>14.37%</u>
Total liabilities and net assets	<u>\$ 15,644,013</u>	<u>\$ 14,487,554</u>	<u>\$ 1,156,459</u>	<u>7.39%</u>

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

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

Net assets of the Office increase \$890 thousand, from \$5.26 million as of June 30, 2013, to \$6.15 million as of June 30, 2014. The increase in net assets was the result of an increase of \$1.15 millions in total assets and a increase of \$280 thousand in total liabilities. The increase in total assets and in total liabilities are mainly due to the following:

- The budget approved by the legislative bodies amounting to \$10.29 million and \$10.32 for the years June 30, 2014 and 2013, respectively.
- Capital assets decrease \$20 thousand as a result of capital expenditures of \$661 thousand that is partially offset by depreciation of \$659 thousand.
- Total liabilities decreased by \$280 thousand, mainly due to an decrease in accounts payable suppliers and a increase in current portion of accrued compensated absence.

The statement of activities shows the sources of the Office's changes in net assets as they arise through its various functions. The Office currently only has governmental activities. Condensed statements of activities for the fiscal years ended June 30, 2014 and 2013 are shown in the table below:

	<u>2014</u>	<u>2013</u>	<u>Change</u>	<u>Percentage</u>
<u>Governmental activities</u>				
Revenues:				
Program revenues				
State appropriations	\$ 10,290,000	\$ 10,320,000	\$ (30,000)	(0.29%)
Interest and other	7,927	10,963	(3,036)	(38.30%)
Total revenues	<u>10,297,927</u>	<u>10,330,963</u>	<u>(33,036)</u>	<u>(.032%)</u>
Expenditures:				
General government	8,809,910	8,705,245	104,665	(2.41%)
Expenditures from specific program:				
Special project	41,493	79,224	(37,731)	(110.38%)
Interest on long - term debt	563,100	569,438	(6,338)	(1.13%)
Total expenses	<u>9,414,503</u>	<u>9,353,907</u>	<u>60,596</u>	<u>(2.77%)</u>
Change in net assets	883,424	977,056	(93,632)	-10.60%
Net assets at:				
Beginning of year	5,263,015	4,285,959	977,056	18.56%
End of year	<u>\$ 6,146,439</u>	<u>\$ 5,263,015</u>	<u>\$ 883,424</u>	<u>14.37%</u>

Total revenues decrease from \$10.32 million in 2013 to \$10.29 million in 2014.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

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

Function/program expenses decrease from \$9.35 million in 2013 to \$9.41 million in 2014. Increased was mainly caused by increases of regular employees and related payroll expenses as result of various act enacted during 2013 and 2014 and control exercise by management in other operating expenses.

GOVERNMENTAL FUND RESULTS

Following is an analysis of the results of operations of the Office's major governmental funds General Fund - This fund accounts for all of the Office's activities. Total expenditures of this fund increased \$530 thousand from \$8.98 million in 2013 to \$9.51 million in 2014. The increase was mainly the result of a increase in payroll and related expenditures of \$180 thousand and the increase in capital outlays of \$436 thousand among a decrease in other expenditures. Total revenues from state appropriation decrease from \$10.32 million in 2013 to \$10.29 million in 2014.

CAPITAL ASSETS

The Office's investment in capital assets at June 30, 2014 and 2013 amounted to approximately \$9.61 million and \$9.59 million, respectively, net of accumulated depreciation and amortization. Capital assets include land, buildings, building improvements, office furniture equipment, computer equipment, vehicles and intangible assets including software. See Note F for the basic financial statements for additional details on capital assets at year-end and on activity during the fiscal year ended June 30, 2014.

LONG-TERM DEBT

The Office obtained long-term debt to finance the acquisition of building for its administrative office. At June 30, 2014, total debt outstanding amounted to \$7 million.

REQUESTS FOR INFORMATION

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

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

STATEMENT OF NET ASSETS
JUNE 30, 2014

- ASSETS -

Cash	\$	5,721,315
Certificate of deposit		250,227
Accounts receivable		1,073
Prepaid expenses		11,021
Deferred financing cost		46,947
Capital assets:		
Non depreciable		2,000,000
Depreciable - net		<u>7,613,430</u>
 Total assets	 \$	 <u>15,644,013</u>

- LIABILITIES AND NET ASSETS -

Current liabilities		
Current portion:		
Accrued compensated absence	\$	695,368
Long-term debt		90,061
Accounts payable		592,391
Accrued liabilities		151,859
Deferred revenues		<u>5,505</u>
 Total current liabilities		 <u>1,535,184</u>
Non-current liabilities		
Accrued compensated absence		1,015,046
Long term debt		<u>6,947,344</u>
 Total non-current liabilities		 <u>7,962,390</u>
 Total liabilities		 <u>9,497,574</u>
Net assets:		
Invested in capital assets		2,639,463
Unrestricted		<u>3,506,976</u>
 Total net assets	 \$	 <u>6,146,439</u>

SEE NOTES TO FINANCIAL STATEMENTS

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

STATEMENT OF ACTIVITIES
FOR THE FISCAL YEAR ENDED JUNE 30, 2014

<u>Functions and programs</u>	<u>Expenses</u>	<u>Program revenues</u>		Net (expenses) revenues and changes in net assets
		<u>Operating Grant and Contributions</u>	<u>Capital Grant and Contributions</u>	
Governmental activities:				
General government	\$ (8,809,910)	\$ 10,290,000	\$ 7,927	\$ 1,488,017
Special projects	(41,493)			(41,493)
Interest on long term debt	<u>(563,100)</u>	<u>-</u>	<u>-</u>	<u>(563,100)</u>
Total governmental activities and change in net assets	\$ <u>(9,414,503)</u>	\$ <u>10,290,000</u>	\$ <u>7,927</u>	883,424
NET ASSETS AT:				
BEGINNING OF YEAR				<u>5,263,015</u>
END OF YEAR				<u>\$ 6,146,439</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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BALANCE SHEET - GOVERNMENTAL FUND
JUNE 30, 2014

	<u>General fund</u>	Total Governmental <u>Funds</u>
ASSETS:		
Cash	\$ 5,721,315	\$ 5,721,315
Certificate of deposit	250,227	250,227
Accounts receivable	<u>1,073</u>	<u>1,073</u>
 Total assets	 <u>\$ 5,972,615</u>	 <u>\$ 5,972,615</u>
 LIABILITIES:		
Accounts payable	\$ 592,391	\$ 592,391
Accrued liabilities:		
Current portion	847,227	847,227
Long term portion	1,015,046	1,015,046
Deferred revenues	<u>5,505</u>	<u>5,505</u>
 Total liabilities	 <u>2,460,169</u>	 <u>2,460,169</u>
 FUND BALANCE:		
Unreserved	<u>3,512,446</u>	<u>3,512,446</u>
Total funds	<u>3,512,446</u>	<u>3,512,446</u>
 Total liabilities and fund balance	 <u>\$ 5,972,615</u>	 <u>\$ 5,972,615</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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BALANCE SHEET RECONCILIATION - GOVERNMENTAL
FUND TO THE STATEMENT OF NET ASSETS JUNE 30, 2014

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

Total fund balance	\$ 3,512,446
Prepaid expenses are not available to pay current period expenditures and, therefore, are not deferred in the funds	11,021
Deferred financing cost are not available to pay current period expenditures and, therefore, are not deferred in the funds	46,947
Capital assets used in governmental activities are not current financial resources and, therefore, are not reported in the Balance Sheet Governmental Fund	9,613,430
Liabilities, including mortgage payable are not due and payable in the current period and, therefore, are not reported in the Balance Sheet-Governmental Fund	<u>(7,037,405)</u>
Net assets of governmental activities	\$ <u>6,146,439</u>

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

STATEMENT OF REVENUES, EXPENDITURES AND
CHANGES IN FUND BALANCE - GOVERNMENTAL FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 2014

	<u>General fund</u>	<u>Total Governmental Funds</u>
REVENUES:		
State appropriations	\$ 10,290,000	\$ 10,290,000
Interest and investment income	<u>7,927</u>	<u>7,927</u>
 Total revenues	 <u>10,297,927</u>	 <u>10,297,927</u>
EXPENDITURES:		
Payroll and related expense	7,193,212	7,193,212
Capital outlays	661,029	661,029
Insurance and related	147,680	147,680
Office equipment and supplies	151,403	151,403
Other expense	133,225	133,225
Rent related expense	15,450	15,450
Repair and maintenance	193,261	193,261
Special projects	41,493	41,493
Professional services	188,195	188,195
Utilities	140,778	140,778
Debt service payments:		
Principal	83,199	83,199
Interest	<u>563,100</u>	<u>563,100</u>
 Total expenditures	 <u>9,512,025</u>	 <u>9,512,025</u>
 Net change in fund balances - governmental funds	 785,902	 785,902
FUND BALANCE AT:		
 BEGINNING OF YEAR	 <u>2,726,544</u>	 <u>2,726,544</u>
 END OF YEAR	 <u>\$ 3,512,446</u>	 <u>\$ 3,512,446</u>

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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RECONCILIATION OF STATEMENT OF REVENUE,
EXPENDITURES AND CHANGE IN FUND BALANCE -
GOVERNMENTAL FUND TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2014

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

Net change in fund balance - governmental funds	\$	785,902
The issuance of long-term debt provides current financial resources while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds; neither transaction, however, has any effect on net assets.		83,199
Some expenses in the statement of activities do not require the use of current financial resources and therefore, are not reported as expenditures in the governmental funds.		(7,206)
Governmental funds report prepaid expenses as expenditures. However, in statement of activities the costs of those assets is allocated over their estimated useful lives and reported as amortization expense. This is the amount by which these expenditures exceeded amortization in the current period.		2,653
Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense and amortization. This is the amount by which capital outlays, net of disposals exceeded depreciation in the current period.		<u>18,876</u>
CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES		<u>\$ 883,424</u>

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

NOTE A - REPORTING ENTITY

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

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

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

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

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

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

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

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

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

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

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

NOTE A - REPORTING ENTITY (Cont'd)

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

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

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

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

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

Government wide and fund financial statements

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

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

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

Restricted net assets result when constraints placed on net assets use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

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

Government wide and fund financial statements (Cont'd)

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

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

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

Measurement focus, basis of accounting and financial statements presentation

Government-wide financial statements

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

Governmental funds financial statements

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

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO
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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

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

Governmental funds financial statements (cont'd)

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

Modifications to the accrual basis of accounting include:

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

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

- General Fund - This fund accounts for all financial resources of the Office, except for those activities related to the federal grant for the cancer registry.

Fund balance

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

- Nonspendable - amounts that cannot be spent either because they are not in a spendable form or because they are legally or contractually required to be maintained intact.
- Restricted - amounts constrained to specific purposes by their providers (such as grantors), through constitutional provisions, or by enabling legislation.
- Committed - amounts constrained to specific purposes by the Center itself, using its highest level of decision-making authority (such as legislation). To be reported as committed, amounts cannot be used for any other purpose unless the Center takes the same highest level action to remove or change the constraint.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

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

Fund balance (cont'd)

- Assigned - amounts the Office intends to use for a specific purpose. Intent can be expressed by the Office or by an official or body to which the Office delegates the authority.
- Unassigned - all amounts not included in other spendable classifications.

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

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

Budgetary accounting

Statutory (budgetary) accounting

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

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

Budgetary control

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS
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NOTE B - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Budgetary control (cont'd)

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

Prepaid expenses

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

Capital assets

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

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

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

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

Use of estimates

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

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MANAGEMENT'S DISCUSSION AND ANALYSIS
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NOTE B - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Cont'd)

Cash and cash equivalents

The Office considers all highly liquid investments with maturity of three (3) months or less when purchased to be cash equivalents. The cash balances are available to meet current operating requirements in various interest-bearing accounts with Commercial Banks.

Compensated absences

The vacation policy of the Commonwealth of Puerto Rico that applies to the Office employees provides for the accumulation of two and a half (2.5) days per month. Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of sixty (60) days. Office's employees accumulate sick leave at a rate of one and a half (1.5) days per month up to a maximum of ninety (90) days. Upon retirement, an employee receives all accumulated unpaid leave at the current rate, if the employee has at least ten (10) years of service with the Commonwealth of Puerto Rico.

Governmental funds

Reservations of fund balance

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

Future adoption of accounting pronouncements

The Governmental Accounting Standards Board ("GASB") has issued the following statements:

GASB Statement No. 72, Fair Value Measurement and Application, which is effective for periods beginning after June 15, 2015.

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

NOTE C - CASH

The level of custodial credit risk assumed by the Office at June 30, 2014 is disclosed below. Custodial credit risk is the risk that in the event of a financial institution failure, the Office'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. The Office does not have a formal policy for custodial credit risk.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
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NOTE C - CASH (Cont'd)

The Office maintains its cash balances in commercial banks. Depository bank accounts at the institution are guaranteed by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000. At December 31, 2014, the cash balances exceeded the insured limit by \$5,200,748.

NOTE D - COMPENSATED ABSENCES

Employees accrue vacation leave at a rate of two and a half (2.5) days per month up to a maximum of sixty (60) days. Unpaid vacation time accumulated is fully vested to the employees from the first (1) day of work.

Employee's accumulated sick leave at a rate of one and a half (1.5) days per month up to a maximum of ninety (90) days. Upon retirement, and employee receives compensation for all accumulated unpaid sick leave at their then current rate of pay, if the employee has at least ten (10) years of services with the Office.

Total vested pay benefits accrued for compensated absences at June 30, 2014, amount to \$1,710,414 which activity for the year ended June 30, 2014, is summarized as follows:

<u>Balance at</u> <u>June 30, 2013</u>	<u>Additions</u>	<u>Decrease</u>	<u>Balance at</u> <u>June 30, 2014</u>	<u>Due within</u> <u>One (1) Year</u>
\$ 1,689,047	\$ 914,431	\$ 893,064	\$ 1,710,414	\$ 695,368

NOTE E - RETIREMENT PLAN

All full-time regular employees are covered and must participate in the employee retirement plan administered by the Employees' Retirement System of the Government of Puerto Rico and its instrumentalities, which is a cost-sharing multiple employer plan. Employees must contribute 5.775% for the first \$550 of their monthly gross salary and 8.275% for the salary in excess of \$550. The Office contributes 9.275% of the total gross salaries.

Effective, July 1, 2011, the Commonwealth of Puerto Rico implemented the increases in the Retirement System that Retirement System Commission approved for all governmental employees. These increases consist of the following:

An increase in the employer contribution from 9.275% to 10.275%, effective in July 1, 2011.

An increase in the annual employer contribution of 1% of the regular retribution received by the participants, beginning on July 1, 2012 and ending on June 30, 2016, and an annual increase of the employer contribution of 1.25% of the regular retribution received by the participant beginning on July 1, 2016 and ending on June 30, 2021.

Total Employer's contributions made for the pension plan during the year ended June 30, 2014, amounted to \$734,695 for employees paid with state funds.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

NOTE F - CAPITAL ASSETS

Capital assets activity for the year ended June 30, 2014, was as follows:

	<u>Beginning Balance</u>	<u>Increase</u>	<u>Decrease other Reclassification</u>	<u>Ending Balance</u>
Non depreciable:				
Land	\$ 2,000,000	\$ -	\$ -	\$ 2,000,000
Depreciable:				
Building	5,375,421	-	-	5,375,421
Building improvements	2,074,434	81,669	-	2,156,103
Office furniture and equipment	1,806,834	16,863	(32,363)	1,791,334
Computer equipment	1,249,398	275,943	(491,362)	1,033,979
Software	-	242,825	256,500	499,325
Vehicle	<u>273,178</u>	<u>43,430</u>	<u>-</u>	<u>316,608</u>
Total capital assets	<u>12,779,265</u>	<u>660,730</u>	<u>(267,225)</u>	<u>13,172,770</u>
Less accumulated depreciation:				
Building	655,851	179,181	-	835,032
Building improvements	276,829	107,805	-	384,634
Office furniture and equipment	1,062,493	240,206	(56,480)	1,246,219
Computer equipment	994,327	50,760	(227,733)	817,354
Software	-	63,438	-	63,438
Vehicle	<u>195,211</u>	<u>17,452</u>	<u>-</u>	<u>212,663</u>
Total accumulate depreciation	<u>3,184,711</u>	<u>658,842</u>	<u>(284,213)</u>	<u>3,559,340</u>
Total capital assets - net	<u>\$ 9,594,554</u>	<u>\$ 1,888</u>	<u>\$ 16,988</u>	<u>\$ 9,613,430</u>

During the year 2014, the Office charged depreciation expense and amortization amounting to \$641,177.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

NOTE G - LONG TERM DEBT

The following is a summary of long term debt as of June 30, 2014:

The Office entered in a loan for the acquisition of real property in the amount of \$7,375,000 on October 23, 2009. The loan at fix interest 7.95% will be paid in 120 equal monthly installments of principal and interest in the amount of \$53,858, starting in November 2009 with a final payment amount to \$6,516,872 on October 31, 2019. The term loan is collateralized by the real property acquired for its administrative facilities. \$ 7,037,404

Less current portion 90,061

Long term debt \$ 6,947,343.

Principal payments required to be made for each of next five years and thereafter are summarized as follows:

<u>Year ending</u> <u>June 30.</u>	<u>Amount</u>
2015	\$ 90,061
2016	97,487
2017	105,526
2018	114,228
2019	123,647
Thereafter	<u>6,506,455</u>
Total	<u>\$ 7,037,404</u>

As a result of this long term debt the office incurred on certain financing cost amounting to \$77,015. These costs were deferred in the accompanying Statement of Net Activities at June 30, 2014 at is amortized based on the effective rate method over the term of the debt. The amortization of this cost at June 30, 2013 amounted to \$7,206.

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MANAGEMENT'S DISCUSSION AND ANALYSIS
AS OF AND FOR THE YEAR ENDED JUNE 30, 2014

NOTE H - CONTINGENCIES

Litigation - At June 30, 2013, the office is defendant in lawsuits arising in the normal course of operations, principally from human resources transactions. According to the laws of the Commonwealth of Puerto Rico, the Office is fully represented by the Puerto Rico Department of Justice in defense of all legal cases against the Office. Any claims with negative financial impact would be paid from the resources of the Office and the Commonwealth of Puerto Rico.

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

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

Each participant will be eligible for one (1) year of medical benefits.

The amount was not discounted since it was paid within the current fiscal year.

NOTE I - SUBSEQUENT EVENTS

Management has evaluated subsequent events through March 30, 2015, the date the financial statements were available to be issued.

OFFICE OF GOVERNMENT ETHICS OF THE COMMONWEALTH OF PUERTO RICO

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BUDGET VS ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 2014

	<u>Original</u> <u>Budget</u>	<u>Final</u> <u>Budget</u>	<u>Actual</u> <u>Expenditures</u>	<u>Variance</u>
Revenue:				
State appropriation	\$ 10,290,000	\$ 10,290,000	\$ 10,290,000	\$ -
Interest and investment income	-	-	7,927	7,927
Total revenues	<u>10,290,000</u>	<u>10,290,000</u>	<u>10,297,927</u>	<u>7,927</u>
Expenditures:				
Payroll and related expenses	7,658,000	7,658,000	7,193,212	(464,788)
Capital outlays	170,000	170,000	661,029	491,029
Insurance and related	234,000	234,000	147,680	(86,320)
Office equipment and supplies	470,000	470,000	151,403	(318,597)
Other expenses	263,000	263,000	133,225	(129,775)
Rent related expenses	54,000	54,000	15,450	(38,550)
Repair and maintenance	353,000	353,000	193,261	(159,739)
Special project	104,000	104,000	41,493	(62,507)
Professional service	247,000	247,000	188,195	(58,805)
Utilities	173,000	173,000	140,778	(32,222)
Debt service payments	<u>564,000</u>	<u>564,000</u>	<u>646,299</u>	<u>82,299</u>
Total expenditures	<u>10,290,000</u>	<u>10,290,000</u>	<u>9,512,025</u>	<u>(777,975)</u>
Net change in fund balances				
- governmental funds	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 785,902</u>	<u>\$ 785,902</u>

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