Government of Puerto Rico
Office of the Governor

Environmental Quality Board

Financial Statement

For the Fiscal Year Ended June 30, 2011

(With The Additional Reports Required By
The Government Auditing Standards and OMB Circular A-133)

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PART I

FINANCIAL

CPA DIAZ-MARTINEZ, PSC
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INDEPENDENT AUDITORS' REPORT

Pedro J. Nieves Miranda, Esq.
President
Environmental Quality Board of the
Government of Puerto Rico

We have audited the accompanying Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Funds of the **Environmental Quality Board of the Government of Puerto Rico (EQB)** for the fiscal year ended June 30, 2011. This statement is the responsibility of **EQB**'s management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, o a test basis, evidence supporting the amounts and disclosures in the financial statement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 2 to the financial statement, **EQB** prepares its Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Funds on the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America.

Also, as discussed in Note 1, the financial statement of **EQB** is intended to present the cash receipts, disbursements, and net changes of the governmental funds of only that portion of the financial reporting entity of the Government of Puerto Rico that is attributable to the transactions of **EQB**. They do not purport to, and do not, present fairly the financial position of the Government of Puerto Rico as of June 30, 2011, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statement referred to previously present fairly, in all material respects, the cash receipts and disbursements of **EQB** governmental funds, and the respective cash basis net changes thereof for the year ended June 30, 2011, in conformity with the basis of accounting described in Note 2.

In accordance with *Government Auditing Standards*, we have also issued our report dated August 31, 2012 on our consideration of EQB's internal control over financial reporting on our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the Statement of Cash Receipts, Disbursements, and Net Changes – Governmental Funds that collectively comprise EQB's financial statement. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the financial statement. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statement. The information has been subjected to the auditing procedures applied in the audit of the financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statement or to the financial statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the financial statement as a whole.

CPA DIAZ-MARTINEZ, PSC
Certified Public Accountants & Consultants
License Number 12, expires on December 1, 2013

Caguas, Puerto Rico
August 31, 2012

	General Fund	Special Revenues Fund	Federal Grants Fund	Total Governmental Funds
CASH RECEIPTS:				
Appropriations from the Government of Puerto Rico	$ 6,595,000	$12,370,290	$ -	$18,965,290
Federal Grants	801,169	-	23,077,380	23,878,549
Fines and Penalties	-	286,770	-	286,770
Total Cash Receipts	7,396,169	12,657,060	23,077,380	43,130,609
CASH DISBURSEMENTS:				
Air Quality Improvement	1,397,731	-	-	1,397,731
Analysis of Environmental Tests	606,821	-	-	606,821
Clean Air Act Project	-	1,722,438	2,300	1,724,738
Emergency Response and Superfund Project	-	2,004,183	233,570	2,237,753
Environmental and Scientific Supporting	347,259	-	-	347,259
General Administration and Direction	3,176,548	7,247,267	-	10,423,815
Land Pollution Control	857,777	-	75,532	933,309
Pneumatic and Recycling Program	-	423,491	-	423,491
Oil Control	-	327,796	-	327,796
Pollution Control	402,152	-	-	402,152
Regional Services	1,480,719	-	-	1,480,719
Studies for Requests of Tax Exemptions	24,934	-	-	24,934
Water Quality Improvement	3,333,456	-	1,383,873	4,717,329
Subtotal	11,627,397	11,725,175	1,695,275	25,047,847
Pass-Through Entity (Capitalization Grants for Clean Water State Revolving Funds)	-	-	21,863,131	21,863,131
Total Cash Disbursements	11,627,397	11,725,175	23,558,406	46,910,978
NET CHANGES	($ 4,231,228)	$ 931,885	($ 481,026)	($ 3,780,369)

See accompanying Notes to this Statement.

1. FINANCIAL REPORTING ENTITY

A. Organization

The Government of Puerto Rico, Office of the Governor, **Environmental Quality Board (EQB)** was established under Law Number 416 of September 22, 2004, as amended. **EQB** is responsible for the protection and conservation of the environment in the Government of Puerto Rico. The Government of Puerto Rico was constituted on July 25, 1952, under provisions of its Constitution as approved by the people of Puerto Rico and the Congress of the United States of America. The Government's Constitution provides for the separation of powers of the executive, legislative and judicial branches of the government. The Government assumes responsibility for public safety, public health, public housing, welfare, education, and economic development.

B. Financial Reporting Entity

The accompanying financial statement includes all divisions whose funds are under the custody and control of **EQB**. In evaluating **EQB** as a reporting entity, management has addressed all the potential component units. The decision to include a potential component unit in the reporting entity was made by applying the provisions of Codification of Governmental Accounting and Financial Reporting Standard, Section 2100.

The basic criteria for including a potential component unit within the reporting entity is if potential component units are financially accountable and other organizations for which the nature and significance of their relationship with the entity are such that exclusion would cause **EQB**'s financial statement to be misleading or incomplete. The GASB has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) ability of **EQB** to impose its will on that organization or (2) the potential for the organization to provide specific financial benefits to, or impose specific financial burdens on **EQB**.

The relative importance of each criterion must be evaluated in light of specific circumstances in order to determine which components units are to be included as part of the reporting entity. Our specific evaluations of the criteria applicable to **EQB** indicate no organizations meet the criteria to be included as component units. Accordingly, this financial statement presents only **EQB** as the reporting entity.

EQB is for financial reporting purposes a part of the Government of Puerto Rico. Because **EQB** is part, for financial reporting purposes, of the Government of Puerto Rico, its financial data is included as part of the Government of Puerto Rico financial statements. **EQB** accompanying financial statement is issued solely to comply with the Single Audit Act Amendments of 1996 (P.L. 104-156) and for the information and used of **EQB**'s management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Statement – Measurement Focus and Basis of Accounting

EQB's accompanying financial statement have been prepared in accordance with the cash basis of accounting, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GGAP) as established by the Governmental Accounting Standards Board. The basis of accounting involves the reporting of only cash and cash equivalents and the changes therein resulting from cash inflows (cash receipts) and cash outflows (cash disbursements) reported in the period in which they occurred.

This cash basis of accounting differs from GAAP primarily because revenue (cash receipts) are recognized when received in cash rather than when earned and susceptible to accrual, and expenditures (cash disbursement) are recognized when paid rather than when incurred of subject to accrual. The amounts reported as cash receipts are those received during the fiscal year 2010-2011. No accrual is recognized.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Capital assets resulting from cash transactions are reported as cash disbursements in the acquiring governmental fund upon cash acquisition. No capital assets are recorded in **EQB**'s financial statement. No long-term debt is reported in **EQB**'s financial statement. No accrued compensated absences are reported in **EQB**'s financial statement. Compensated absences resulting from cash transactions are reported as cash disbursements in the governmental funds column upon cash payment.

The accounts of **EQB** are organized on the basis of fund types, which are responsible for the coordination, receipt, and management of funds principally approved by the U.S. Environmental Protection Agency (EPA). These are composed of three funds which are described below. The accounts of **EQB** are accounted for with a set of accounts which is only include cash receipts and cash disbursements. No balance sheet accounts are maintained or reported.

The following individual programs account for the governmental resources allocated to them for the purpose of carrying on specified activities in accordance with laws, regulations, and other restrictions:

- ***General Fund*** – The general fund is the main operating fund of **EQB**. It is used to account for all financial resources except those required to be accounted for separately.
- ***Special Revenues Fund*** – Accounts for proceeds received through fines and penalties imposed to entities in Puerto Rico to assure compliance with federal and local environmental laws; and resources received from Indirect Costs Reimbursement from the Environmental Protection Agency.
- ***Federal Grants Fund*** – Accounts for the financial resources related to the Federal Grant Awards administered by **EQB**.

Notes to the Financial Statement

The notes to the financial statement provide information that is essential to a user's full understanding of the data provided in the financial statement.

B. Stewardship, Compliance, and Accountability

Budgetary Information

The revenues recognized in the General Fund consist of appropriations from the Office of Management and Budget of the Government of Puerto Rico for recurrent and ordinary functions of **EQB**. The procedures followed in approving the annual budget is as follows:

a. Between November and December **EQB** submits to the Office of Management and Budget of the Government of Puerto Rico an operating budget petition for the fiscal year commencing the following July 1.

b. At the beginning of the ordinary session of the Legislative Assembly of the Government of Puerto Rico, the Governor submits a proposed budget for the fiscal year covering the whole operations of the Government. This proposed budget includes estimated expenditures and the means of financing them.

c. The annual budget is legally enacted through the approval by the Legislative Assembly of the Joint Resolution of the General Budget. Subsequently to enactment, the Office of Management and Budget of the Government has the authority to make the necessary adjustments to the budget.

Federal grant funds can be carried over a specified amount of time, upon request to, and approval by EPA. The financial statement is presented at the programmatic level. However, budgetary control and accounting is exercised at a lower level providing management with detailed control over expenditures at an appropriated budget level. Budgetary Comparison Schedule is not legally required to do so.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

C. Interfund Transactions

EQB has the following type of transactions among funds:

Interfund Transfers – Legally required transfers that are reported when incurred as transfers-in by the recipient fund and as transfers-out by the disbursing fund.

D. Risk Financing

EQB is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions, injuries to employees' health, and natural disasters. Commercial insurance policies covering such risk are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities and Government of Puerto Rico instrumentalities. Also, principal officials of **EQB** are covered under various surety bonds. Management believes such coverage is sufficient to preclude any significant uninsured losses to **EQB**.

E. Accounting for Pension Costs

EQB adopted the provisions of Codification of Governmental Accounting and Financial Reporting Standard Section Pe5, Pension Plans – Defined Benefit, by requiring disclosure of how the contractually required contribution rate is determined by governments participating in multi-employer cost-sharing pension plans.

EQB accounts for pension costs from the standpoint of a participant in a multiple-employer cost-sharing plan. Accordingly, pension costs recognized in the accompanying financial statement are equal to the statutorily required contributions, with a liability recorded for any unpaid required contributions.

For the purpose of applying the requirements of the Codification, the Government is considered to be the sponsor of the Employees' Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS) and System 2000, a multiemployer cost-sharing defined benefit pension plan and a hybrid defined contribution plan, respectively, in which the employees of **EQB** participate. **EQB** is considered a participant, and not a sponsor, of these retirement systems since the majority of the participants in the aforementioned pension trust funds are employees of the Government and the basic financial statements of such retirement systems are part of the financial reporting entity of the Government.

F. Future Adoption of Accounting Pronouncements

The GASB issued the following pronouncements that have effective dates after June 30, 2011:

GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans.* The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2011.

GASB Statement No. 59, *Financial Instruments Omnibus.* The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

GASB Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements.* The objective of this Statement is to improve financial reporting by addressing issues related to service concession arrangements (SCAs), which are a type of public-private or public-public partnership. As used in this Statement, an SCA is an arrangement between a transferor (a government) and an operator (governmental or nongovernmental entity) in which (1) the transferor conveys to an operator the right and related obligation to provide services through the use of infrastructure or another public asset (a "facility") in exchange for significant consideration and (2) the operator collects and is compensated by fees from third parties.

This Statement requires disclosures about an SCA including a general description of the arrangement and information about the associated assets, liabilities, and deferred inflows, the rights granted and retained, and guarantees and commitments. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

GASB Statement No. 61, *The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34.* The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements.

This Statement modifies certain requirements for inclusion of component units in the financial reporting entity. For organizations that previously were required to be included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Further, for organizations that do not meet the financial accountability criteria for inclusion as component units but that, nevertheless, should be included because the primary government's management determines that it would be misleading to exclude them, this Statement clarifies the manner in which that determination should be made and the types of relationships that generally should be considered in making the determination.

This Statement also amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. Lastly, additional reporting guidance is provided for blending a component unit if the primary government is a business-type activity that uses a single column presentation for financial reporting. This Statement also clarifies the reporting of equity interests in legally separate organizations. It requires a primary government to report its equity interest in a component unit as an asset. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012. Earlier application is encouraged.

GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The objective of this Statement is to incorporate into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

Hereinafter, these pronouncements collectively are referred to as the "FASB and AICPA pronouncements." This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* thereby eliminating the election provided in paragraph 7 of that Statement for enterprise funds and business-type activities to apply post-November 30, 1989 FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged. The provisions of this Statement generally are required to be applied retroactively for all periods presented.

EQB's financial statement was not affected by the implementation of these statements.

GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements,* introduced and defined those elements as a consumption of net assets by the government that is applicable to a future reporting period, and an acquisition of net assets by the government that is applicable to a future reporting period, respectively. Previous financial reporting standards do not include guidance for reporting those financial statement elements, which are distinct from assets and liabilities.

Concepts Statement 4 also identifies net position as the residual of all other elements presented in a statement of financial position. This Statement amends the net asset reporting requirements in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. Earlier application is encouraged.

EQB has not yet determined the effect this statement will have on **EQB**'s financial statement.

GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53.* Some governments have entered into interest rate swap agreements and commodity swap agreements in which a swap counterparty, or the swap counterparty's credit support provider, commits or experience either an act of default or a termination event as both are described in the swap agreement. Many of those governments have replaced their swap counterparty, or swap counterparty's credit support providers, either by amending existing swap agreements or by entering into new swap agreements. When these swap agreements have been reported as hedging instruments, questions have arisen regarding the application of the termination of hedge accounting provisions in Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* Those provisions require a government to cease hedge accounting upon the termination of the hedging derivative instrument, resulting in the immediate recognition of the deferred outflows of resources or deferred inflows of resources as a component of investment income.

The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. Earlier application is encouraged.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. Concepts Statement No. 4, *Elements of Financial Statements*, specifies that recognition of deferred outflows and deferred inflows should be limited to those instances specifically identified in authoritative GASB pronouncements. Consequently, guidance was needed to determine which balances being reported as assets and liabilities should actually be reported as deferred outflows of resources or deferred inflows of resources, according to the definitions in Concepts Statement 4. Based on those definitions, Statement 65 reclassifies certain items currently being reported as assets and liabilities as deferred outflows of resources and deferred inflows of resources. In addition, this Statement recognizes certain items currently being reported as assets and liabilities as outflows of resources and inflows of resources. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

Statement 66 amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. As a result, governments would base their decisions about governmental fund type usage for risk financing activities on the definitions in Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.*

This Statement also amends Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. These changes would eliminate any uncertainty regarding the application of Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases*, and result in guidance that is consistent with the requirements in Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, respectively. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

EQB's financial statement was not affected by the implementation of these statements.

GASB Statement No. 67, *Financial Reporting for Pension Plans*. This Statement replaces the requirements of Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans *and Statement No. 50,* Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27, as they relate to pension plans that are administered through trusts or similar arrangements meeting certain criteria. The Statement builds upon the existing framework for financial reports of defined benefit pension plans, which includes a statement of fiduciary net position (the amount held in a trust for paying retirement benefits) and a statement of changes in fiduciary net position. Statement No. 67 enhances note disclosures and RSI for both defined benefit and defined contribution pension plans. Statement No. 67 also requires the presentation of new information about annual money-weighted rates of return in the notes to the financial statements and in 10-year RSI schedules. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014. Earlier application is encouraged.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES – continuation

GASB Statement No. 68, *Accounting and Financial Reporting* for Pensions. This Statement replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers *and Statement No. 50,* Pension Disclosures—an amendment of GASB Statements No. 25 and No. 27, as they relate to governments that provide pensions through pension plans administered as trusts or similar arrangements that meet certain criteria. Statement No. 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits. The Statement also enhances accountability and transparency though revised and new note disclosures and required supplementary information. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2014. Earlier application is encouraged.

EQB has not yet determined the effect this statement will have on **EQB**'s financial statements.

3. CASH

Cash in Banks

The funds of **EQB** are under the custody and control of the Secretary of the Treasury Department of Puerto Rico pursuant to Act No. 230 of July 23, 1974, as amended, known as "Government of Puerto Rico Accounting Law". The Treasury Department follows the practice of pooling cash equivalents under the custody and control of the Secretary of the Treasury. The funds of **EQB** in such pooled cash accounts are available to meet its current operating requirements.

EQB's cash at June 30, 2011 are demand deposits in the Government Development Bank of Puerto Rico (GDB), and are recorded at cost, which approximates fair value.

4. LEASE COMMITMENTS

EQB rent its facilities through operating lease agreements with private entities. Rent disbursed under such lease agreements for the year ended June 30, 2011 amounted to approximately $774,862. This amount should be approximately the same expenditures in the following five fiscal years.

5. PENSION PLAN

Description of the Plan

Employees of **EQB** participate in the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). The ERS is cost-sharing multiple-employer defined benefit pension plan sponsored by the Government under the Act No. 447, approved on May 15, 1951, as amended. ERS covers all regular employees of the Government and its instrumentalities and of certain municipalities and components units not covered by their own retirement systems.

Participation is mandatory except for members of the Legislature, Government Secretaries, Head of Agencies and Public Instrumentalities, Assistants to the Governor, the Comptroller of the Puerto Rico, Gubernatorial Board and Committee appointees and Experimental Service Station employees. ERS provides retirement, death and disability benefits. Disability retirement benefits are available to members for occupational and non-occupational disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after ten years of plan participation.

5. PENSION PLAN – continuation

Members who have attained at least 55 years of age and have completed at least 25 years of creditable service or members who have attained at least 58 years of age and have completed at least 10 years of creditable service are entitled to an annual benefit, payable monthly for life. The amount of the annuity shall be 1.5% of the average salary, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average salary, as defined, multiplied by the number of years of creditable service in excess of 20 years. In no case will the annuity be less than $200 per month.

Participants who have completed at least 30 years of creditable service are entitled to receive the Merit Annuity. Participants who have not attained 55 years of age will receive up to a maximum of 65% of the average salary, as defined, or if they have attained 55 years of age will receive up to a maximum of 75% of the average salary, as defined. Disability retirement benefits are available to members for occupational disability up to a maximum benefit of 50% of the average salary, as defined. However, for non-occupational disability, a member must have at least 10 years of creditable services.

The contribution requirements for both employees and employers are established by law and are not actuarially determined. Employees are required to contribute 5.775% for the first $550 of monthly salary plus 8.275% for the excess of this amount, or on the alternative, 8.275% of their monthly gross salary. **EQB** is required by Act No. 447 to contribute 9.275% of its employees' gross salaries.

Act No. 1 of 1990 made certain amendments applicable to new participants joining the ERS effective April 1, 1990. These changes consist principally of the establishment of contributions at 8.275% of their monthly gross salary, an increase in the retirement age to 65, a decrease in the annuity benefit to 1.5% of the average salary, as defined, for all years of creditable services, a decrease in the maximum disability, and death benefits annuities from 50% to 40% of average salary, as defined, and the elimination of the Merit Annuity for participants who have completed 30 years of creditable services.

Law Number 305 was enacted on September 24, 1999, amended the Act Number 447 for the purpose of establishing a new program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system (ERS) as of December 31, 1999, may elect either to stay in the defined-benefit plan or transfer to the new program. Persons joining the government on or after January 1, 2000, will only be allowed to become members of System 2000.

System 2000 is a hybrid defined contribution plan, also known as a cash balance plan. Under this new plan there will be a pool of pension assets, which will be invested by the System, together with those of the current defined-benefit plan. Benefits at retirement age will not be guaranteed by the Government. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% up to a maximum of 10%) of their monthly salary, and will be invested in an account which will either: (a) earn a fixed rate based on the two-year Constant Maturity Treasury Note or, (b) earn a rate equal to 75% of the return of the System's investment portfolio (net of management fees), or (c) earn a combination of both alternatives. Participants receive periodic account statements similar to those of defined contribution plans showing their accrued balances. Disability pensions are not being granted under System 2000. The employers' contributions (9.275% of the employees' salary) will be used to fund the current plan.

If at time of retirement accumulated benefits amount to $10,000 or less may elect to receive a lump sum distribution up to the accumulated benefits. Under the new program the retirement age is reduced from 65 to 60 for those employees who joined the current plan on or after April 1, 1990.

5. PENSION PLAN – continuation

Funding Policy

The authority under which the funding policy and the obligations to contribute to the ERS and System 2000 by the plans' members, employers and other contributing entities (state of municipal contributions), are established or may be amended by law.

Contribution requirements are established by law and are as follows:

EQB	9.275% of gross salary
Employees:	
Hired on or before March 31, 1990	5.775% of gross salary up to $6,600 8.275% of gross salary over $6,600
Hired on or after April 1, 1990	8.275% of gross salary

Annual Contribution

EQB's contributions during those years are recognized as total pension expenditures/expenses in the category of administration.

The amount contributed represented the 100% of the required contribution for the corresponding year. Additionally, changes made in the types and amounts of benefits offered by special laws and costs of living adjustments, led to a one-time recommended contribution to fund the retroactive adjustment related to the changes.

The Employee's Retirement System of the Government of Puerto Rico provides additional information of the ERS and System 2000. They issue a publicly available financial report that includes financial statements and required supplementary information for ERS, as a component unit of the Government. That report may be obtained by writing to the Administration at PO Box 42003, Minillas Station, San Juan, PR 00940-2003.

6. CONTINGENCIES

Federal Awards

In the normal course of operations, **EQB** participates in various federal grant agreements from year to year. The expenditures financed by grants are subject to program compliance audits by the grantor and passed-through agencies in order to assure compliance with grant requirements. Also, **EQB** being the pass-through entity has to monitor the activities or subrecipients as necessary to ensure that Federal Awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and those performance goals are achieved.

Of the federal expenditures authorized for the fiscal year 2010-2011 to the subrecipient Puerto Rico Aqueduct Sewer Authority (PRASA), the auditors determined that cost amounting $5,064,240 are disallowed. Although, **EQB** had authorized this amount, **EQB** had commence a discounting process in the next reimbursement payments, with an expectation to discount the full amount before the PRASA get the project final reimbursement payment.

EQB is also subject to audits performed by the Office of the Comptroller of Puerto Rico.

6. CONTINGENCIES – continuation

Litigation

EQB is a party to various legal proceedings that normally occur in the course of governmental operations. As a result of **EQB**'s use of the cash basis of accounting, the financial statement do not include accrual or provisions for loss contingencies that may result from these proceedings. Although the outcome of the proceedings cannot be predicted due to the insurance coverage maintained by the Government and the statute relating to judgments, **EQB** believes that any settlement or judgment not covered by insurance would not have a material adverse effect on the financial statement of **EQB**.

7. RELATED PARTY TRANSACTIONS

EQB has the following transactions with governmental units:

- **EQB** paid to Puerto Rico Electric Power Authority the amount of $595,072 for services provided during the fiscal year ended June 30, 2011.

- **EQB** paid to Puerto Rico Industrial Development Company the amount of $60,834 for rental of facilities during the fiscal year ended June 30, 2011.

8. SUBSEQUENT EVENT

EQB has evaluated subsequent events through August 31, 2012, the date which the financial statement were available to be issued. No additional subsequent events were identified that should be disclosed or adjusted in the financial statement or its notes.

END OF NOTES