



DEPARTAMENTO DEL  
**TRABAJO**  
Y RECURSOS HUMANOS  
GOBIERNO DE PUERTO RICO

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND  
HUMAN RESOURCES**

**ENTERPRISE FUNDS  
BASIC FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED JUNE 30, 2011**

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND  
HUMAN RESOURCES**

**ENTERPRISE FUNDS  
BASIC FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED JUNE 30, 2011**

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**ENTERPRISE FUNDS  
FOR THE YEAR ENDED JUNE 30, 2011**

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# VALDES, GARCIA , MARIN & MARTINEZ, LLP

CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS  
MEMBER OF THE AICPA PRIVATE COMPANIES PRACTICE SECTION

P.O. Box 36483 I  
SAN JUAN, P.R. 00936-483 I

TELEPHONE: (787) 725-1600  
TELEFAX: (787) 721-2795

## INDEPENDENT AUDITORS' REPORT

To the Honorable Secretary and Management of the  
Commonwealth of Puerto Rico  
Department of Labor and Human Resources  
San Juan, Puerto Rico

We have audited the accompanying basic financial statements of the Unemployment Insurance Fund, the Disability Insurance Fund and the Drivers' Insurance Fund of the Department of Labor and Human Resources (the Department) as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the Department's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the fourth paragraph, 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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 opinion.

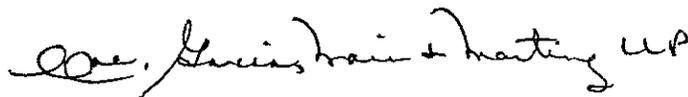
As discussed in Note 1, the financial statements present only the Unemployment Insurance Fund, the Disability Insurance Fund and the Drivers' Insurance Fund and do not purport to, and do not, present fairly the financial position of the Department, as of June 30, 2011 and the changes in its financial 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.

As discussed in Note 3 to the accompanying basic financial statements, because of inadequacies in the Department's accounting records, we were unable to form an opinion regarding the amount of the Unemployment Insurance Fund cash and cash equivalents in governmental bank – restricted amount in the accompanying Statement of Net Assets (stated at \$15,841,410).

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had the Unemployment Insurance Fund cash and cash equivalents in governmental bank – restricted been susceptible to satisfactory audit tests, the financial statements referred to above present fairly, in all material respects, the financial position of the Unemployment Insurance Fund, the Disability Insurance Fund and the Drivers' Insurance Fund of the Department as of June 30, 2011, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 6 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. 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.

This report is intended solely for the information and use of the Department's management, the Honorable Secretary and the Commonwealth of Puerto Rico, and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to read "Jose Luis Garcia" followed by some less legible characters and "UP".

San Juan, Puerto Rico  
February 21, 2012

Stamp 2632869 was affixed  
to the original.

# COMMONWEALTH OF PUERTO RICO

## DEPARTMENT OF LABOR AND HUMAN RESOURCES

### ENTERPRISE FUNDS MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JUNE 30, 2011

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The Department of Labor and Human Resources of the Commonwealth of Puerto Rico (the "Department") provides this Management Discussion and Analysis (MD&A) to the readers of the Department's enterprise funds' basic financial statements. These basic financial statements include only the Department's Unemployment Insurance Fund, Disability Insurance Fund, and Drivers' Insurance Fund (collectively the "enterprise funds"), proprietary funds of the Commonwealth of Puerto Rico ("the Commonwealth"). This MD&A provides a narrative overview and analysis of the financial activities of the Department's enterprise funds as of and for the year ended June 30, 2011. The MD&A is designed to: (a) assist the reader in focusing on significant financial matters, (b) provide an overview of the Department's enterprise funds' financial activities, and (c) highlight individual fund matters. Since the MD&A is designed to focus on the current year activities, resulting changes and currently known facts, it should be read in conjunction with the Department's enterprise funds' basic financial statements, including the notes thereto.

#### FINANCIAL HIGHLIGHTS

- The total assets of the Department's enterprise funds exceeded its total liabilities by \$411,207,773 at the close of fiscal year 2011.
- Total assets of the Department's enterprise funds amounted to \$531,312,689, which represents a decrease of \$32,803,734 (6%) compared with fiscal year 2010. Total liabilities of the Department's enterprise funds amounted to \$120,104,916, which represents a decrease of \$42,167,665 (26%), as compared with fiscal year 2010.
- The net assets of the Department's enterprise funds increased by \$9,363,931 (2%) as a result of this year's operations. Two main areas contributed to this increase: the net decrease in benefits payable of \$30,786,789, net of the related decrease in cash and cash equivalents mainly used to pay such benefits of \$17,305,213.

#### OVERVIEW OF THE ENTERPRISE FUNDS' BASIC FINANCIAL STATEMENTS

This Management Discussion and Analysis is required supplementary information to the enterprise funds' basic financial statements and is intended to serve as introduction to the basic financial statements of the Department's enterprise funds. The Department's enterprise funds' basic financial statements comprise (1) financial statements, and (2) notes to the basic financial statements. These components are described below.

**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 Department's enterprise funds, like other state departments, use fund accounting to ensure and demonstrate compliance with finance related legal requirements. The Department's funds presented in these financial statements are only its enterprise funds.

**Enterprise funds:** The Department uses enterprise funds to account for the Unemployment Insurance, the Disability Insurance and the Drivers' Insurance funds.

The Department's enterprise funds' basic financial statements can be found on pages 7 through 9 of this report.

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**ENTERPRISE FUNDS  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011**

**OVERVIEW OF THE ENTERPRISE FUNDS' BASIC FINANCIAL STATEMENTS (CONTINUED)**

**Notes to Enterprise Funds' Basic Financial Statements:** The notes provide information that is essential to a full understanding of the data provided about the Department's enterprise funds. The notes to the enterprise funds' basic financial statements can be found on pages 10 through 30 of this report.

**FINANCIAL ANALYSIS OF THE DEPARTMENT'S ENTERPRISE FUNDS**

As noted earlier, the Department's enterprise funds use fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

**Net Assets**

The Department's enterprise funds reported combined ending fund net assets amounting to \$411,207,773 at the close of current fiscal year. The following condensed Statements of Net Assets serve over time as an useful indicator of the Department's enterprise funds' financial position at the end of the fiscal years ended June 30, 2011 and 2010.

	Condensed Statements of Net Assets		
	2011	2010 (As restated)	Change
Current assets	\$ 478,039,571	\$ 511,926,463	\$ (33,886,892)
Noncurrent assets	53,273,118	52,189,960	1,083,158
<b>Total assets</b>	<b>531,312,689</b>	<b>564,116,423</b>	<b>(32,803,734)</b>
Current liabilities	118,626,350	160,659,297	(42,032,947)
Noncurrent liabilities	1,478,566	1,613,284	(134,718)
<b>Total liabilities</b>	<b>120,104,916</b>	<b>162,272,581</b>	<b>(42,167,665)</b>
<b>Net assets:</b>			
Restricted for benefits payments	330,925,388	322,006,226	8,919,162
Unrestricted	80,282,385	79,837,616	444,769
<b>Total net assets</b>	<b>\$ 411,207,773</b>	<b>\$ 401,843,842</b>	<b>\$ 9,363,931</b>

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**ENTERPRISE FUNDS  
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011**

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**FINANCIAL ANALYSIS OF THE DEPARTMENT'S ENTERPRISE FUNDS (CONTINUED)**

**Enterprise Funds Highlights**

The following are some of the most important financial highlights of the Department's enterprise funds' financial statements:

- The enterprise funds' net assets increased by **\$9,363,931** as a result of operations. This resulted mainly from the increase in net assets of approximately **\$4,930,100** from the Unemployment Insurance Fund and **\$4,672,100** from the Disability Insurance Fund.
- Total operating revenues amounted to **\$294,213,948**, which represents an increase of **\$49,011,710 (17%)** compared with fiscal year 2010.
- Total operating expenses of the Department's enterprise funds exceeded total revenues for a net operating loss of **\$360,182,221**. This was offset by nonoperating revenues, mainly contributions from the federal government for unemployment insurance benefits payments and interest and investment earnings.
- Total benefits expense of the Department's enterprise funds to eligible citizens during the year ended June 30, 2011 amounted to **\$638,557,600**, which represents decrease of approximately **\$199,866,700 (31%)** compared with fiscal year 2010.

**ECONOMIC FACTORS**

The economic factors of the Department's enterprise funds must be analyzed as a component of the Commonwealth. The Commonwealth is currently in a recession that began at the end of the fiscal year 2006, and also affected by the policies and performance of the United States economy. The average unemployment rate for the Commonwealth was 15.9% in the fiscal year 2011, which decreased by 0.1% compared to the fiscal year 2010. Based on the Puerto Rico Planning Board, the economy is expected to reflect an increase of 0.7% for the fiscal year 2012. Moreover, the average unemployment rate will decline in 2012, since the total employment average again should increase in 2012.

The Department's enterprise funds expect to transfer unrestricted funds from the Disability and Driver's Insurance Funds as additional resources to the Department's general fund, as has occurred since the fiscal year 2007.

**REQUESTS FOR INFORMATION**

This report is designed to provide a general overview of the Department's enterprise funds' finances and to demonstrate the accountability of these funds administered by the Department. For questions regarding the information provided or additional financial information requests please contact the Assistant Secretary of Management Affairs of the Department of Labor and Human Resources, PO Box 195540, San Juan, Puerto Rico 00919-5540.

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN  
FUND NET ASSETS – ENTERPRISE FUNDS  
FOR THE YEAR ENDED JUNE 30, 2011**

	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Total Enterprise Funds
<b>ASSETS</b>				
Current assets:				
Cash and cash equivalents in commercial bank	\$ -	\$ 43,187	\$ 17,849	\$ 61,036
Cash and cash equivalents in governmental bank	-	6,790,131	5,573,126	12,363,257
Cash and cash equivalents in commercial bank - restricted	870,475	473,107	-	1,343,582
Cash and cash equivalents in governmental bank - restricted	15,851,410	-	-	15,851,410
Cash held by PR Secretary of Treasury	-	44,741,312	4,747,948	49,489,260
Cash held by US Treasury - restricted	339,666,242	-	-	339,666,242
Receivable, net:				
Insurance premiums, net	50,143,601	2,808,703	1,060,634	54,012,938
Accrued insurance interest	1,336,496	101,444	-	1,437,940
Accrued investment interest	-	210,124	-	210,124
Due from other funds	-	-	2,682,241	2,682,241
Intergovernmental receivables	845,276	-	-	845,276
Other	38,890	-	37,375	76,265
Total current assets	408,752,390	55,168,008	14,119,173	478,039,571
Noncurrent assets:				
Due from other funds	-	-	18,115,864	18,115,864
Restricted investments	-	35,157,254	-	35,157,254
<b>TOTAL ASSETS</b>	<b>408,752,390</b>	<b>90,325,262</b>	<b>32,235,037</b>	<b>531,312,689</b>
<b>LIABILITIES AND NET ASSETS</b>				
Current liabilities:				
Accounts payable and accrued liabilities	-	655,761	165,472	821,233
Due to other funds	16,729,044	803,395	-	17,532,439
Deferred revenue	10,513,193	2,050,502	18,467	12,582,162
Due to other governmental entities	-	313,801	154,640	468,441
Compensated absences	-	554,408	329,451	883,859
Insurance benefits payable	85,782,760	432,367	123,089	86,338,216
Total current liabilities	113,024,997	4,810,234	791,119	118,626,350
Noncurrent liabilities:				
Due to other governmental entities	-	164,292	85,184	249,476
Compensated absences	-	734,913	494,177	1,229,090
<b>TOTAL LIABILITIES</b>	<b>113,024,997</b>	<b>5,709,439</b>	<b>1,370,480</b>	<b>120,104,916</b>
<b>NET ASSETS:</b>				
Restricted for payment of insurance benefits	295,727,393	35,197,995	-	330,925,388
Unrestricted	-	49,417,828	30,864,557	80,282,385
<b>TOTAL NET ASSETS</b>	<b>\$ 295,727,393</b>	<b>\$ 84,615,823</b>	<b>\$ 30,864,557</b>	<b>\$ 411,207,773</b>

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN  
FUND NET ASSETS – ENTERPRISE FUNDS  
FOR THE YEAR ENDED JUNE 30, 2011**

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	<u>Unemployment Insurance</u>	<u>Disability Insurance</u>	<u>Drivers' Insurance</u>	<u>Total Enterprise Funds</u>
<b>OPERATING REVENUES:</b>				
Insurance premiums	\$ 272,105,361	\$ 17,590,669	\$ 4,515,146	\$ 294,211,176
Other	-	266	2,506	2,772
Total operating revenues	<u>272,105,361</u>	<u>17,590,935</u>	<u>4,517,652</u>	<u>294,213,948</u>
<b>OPERATING EXPENSES:</b>				
Insurance benefits	635,145,180	2,616,687	795,733	638,557,600
General and administrative expenses	-	11,949,005	3,889,564	15,838,589
Total operating expenses	<u>635,145,180</u>	<u>14,565,692</u>	<u>4,685,297</u>	<u>654,396,169</u>
<b>OPERATING INCOME (LOSS)</b>	<u>(363,039,819)</u>	<u>3,025,243</u>	<u>(167,645)</u>	<u>(360,182,221)</u>
<b>NONOPERATING REVENUES:</b>				
Contributions from federal government	406,139,890	-	-	406,139,890
Contributions from US state governments	212,263	-	-	212,263
Interest and investment earnings	12,822,487	4,793,612	26,749	17,642,848
Total nonoperating revenues	<u>419,174,640</u>	<u>4,793,612</u>	<u>26,749</u>	<u>423,995,001</u>
<b>INCOME (LOSS) BEFORE TRANSFERS</b>	56,134,821	7,818,855	(140,896)	63,812,780
<b>TRANSFERS TO OTHER FUNDS</b>	<u>(51,204,676)</u>	<u>(3,146,789)</u>	<u>(97,384)</u>	<u>(54,448,849)</u>
<b>NET CHANGE IN NET ASSETS</b>	4,930,145	4,672,066	(238,280)	9,363,931
<b>NET ASSETS - Beginning of year, as restated</b>	<u>290,797,248</u>	<u>79,943,757</u>	<u>31,102,837</u>	<u>401,843,842</u>
<b>NET ASSETS - End of year</b>	<u>\$ 295,727,393</u>	<u>\$ 84,615,823</u>	<u>\$ 30,864,557</u>	<u>\$ 411,207,773</u>

The notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**STATEMENT OF CASH FLOWS – ENTERPRISE FUNDS  
FOR THE YEAR ENDED JUNE 30, 2011**

	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Total Enterprise Funds
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>				
Receipts from insurance taxes	\$ 282,623,581	\$ 17,656,898	\$ 4,468,051	\$ 304,748,530
Other receipts	-	-	2,506	2,506
Payments to suppliers	-	(7,467,915)	(933,183)	(8,401,098)
Payments to employees	-	(4,975,510)	(3,222,631)	(8,198,141)
Payments for insurance benefits	(665,837,341)	(2,745,119)	(985,673)	(669,568,133)
Net cash provided by (used in) operating activities	(383,213,760)	2,468,354	(670,930)	(381,416,336)
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:</b>				
Contributions from federal government	406,488,847	-	-	406,488,847
Contributions from US state governments	248,410	-	-	248,410
Transfers to other funds	(52,782,633)	(3,146,789)	(97,384)	(56,026,806)
Net cash provided by (used in) noncapital financing activities	353,954,624	(3,146,789)	(97,384)	350,710,451
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>				
Interest received on deposits, investments and loans	12,822,487	1,162,215	56,366	14,041,068
Proceeds from sales and maturities of investments	-	7,850,900	-	7,850,900
Purchase of investments	-	(8,491,297)	-	(8,491,297)
Net cash provided by investing activities	12,822,487	521,818	56,366	13,400,671
<b>NET CHANGE CASH AND CASH EQUIVALENTS</b>	(16,436,649)	(156,617)	(711,948)	(17,305,214)
<b>CASH AND CASH EQUIVALENTS - Beginning of year as restated</b>	372,824,776	52,204,354	11,050,871	436,080,001
<b>CASH AND CASH EQUIVALENTS - End of year</b>	\$ 356,388,127	\$ 52,047,737	\$ 10,338,923	\$ 418,774,787
<b>RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>				
Operating Income (loss)	\$ (363,039,819)	\$ 3,025,243	\$ (167,645)	\$ (360,182,221)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities				
Changes in operating assets and liabilities:				
(Increase) decrease in accounts receivable	18,478,633	457,348	(44,309)	18,891,672
Decrease in due from other funds	-	7,355	-	7,355
Decrease in accounts payable and accrued liabilities	-	(59,427)	(103,050)	(162,477)
Increase (decrease) in deferred revenues	(7,960,413)	(398,740)	(152,977)	(8,512,130)
Decrease in due to other governmental entities	-	(511,730)	(2,785)	(514,515)
Increase (decrease) in compensated absences	-	76,737	(10,224)	66,513
Decrease in insurance benefits payable	(30,692,161)	(128,432)	(189,940)	(31,010,533)
Total adjustments	(20,173,941)	(556,889)	(503,285)	(21,234,115)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	\$ (383,213,760)	\$ 2,468,354	\$ (670,930)	\$ (381,416,336)

The notes to the basic financial statements are an integral part of this statement.

**COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES**

**ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011**

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**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**A. Reporting Entity (Continued)**

State responsibilities include: (1) establishing specific, detailed policies and operating procedures which comply with the requirements of federal laws and regulations; (2) determining the State UI tax structure; (3) collecting State UI contributions from employers (commonly called "unemployment taxes"); (4) determining claimant eligibility and disqualification provisions; (5) making payment of Regular Unemployment (UC) benefits to claimants; (6) managing the program's revenue and benefit administrative functions; (7) administering the programs in accordance with established policies and procedures; and (8) enacting State UC law that conforms with Federal UC law.

The Federal Unemployment Tax Act (FUTA) imposes a federal tax on covered employers. Currently, the FUTA tax on covered employment (generally Employment subject to a State UI tax) is 6.2 percent of the first \$7,000 of covered employee wages. Employers, however, receive two credits against the FUTA tax. One credit is equal to the amount of State UI tax paid by the employer. The employer receives this credit when the State UI law, and its application, conforms and substantially complies with FUTA requirements.

A second credit is awarded only to employers in states, which have a federally approved experience-rate State UI tax system. All states currently meet the federal criteria for both credits to be applicable to the states' employers. The two credits combined cannot exceed 5.4 percent of taxable employee wages.

FUTA revenues from the remaining 0.8 percent are collected by the IRS and deposited into the general fund of the US Treasury, which by statute are appropriated to the UTF. FUTA revenues are used primarily to finance federal and state administrative expenses, the federal share of Extended Benefits (EB) and advances to states whose UTF account balances are low or exhausted. US DOL allocates available administrative grant funds (as appropriated by Congress) to states based on forecasted workload and costs and adjusted for increases or decreases in workload during the current year.

The quarterly tax rate imposed for the State UI Program is computed based on experience rates determined for each employer individually. In addition, a special tax of 1% of taxable compensation will be collected from all nongovernmental employers to promote activities related to the creation of jobs and other related working initiatives. However, the total tax imposed will never be more than 5.4% of the taxable salaries as established by federal regulations.

Unemployment benefits are provided under UC and the EB programs as follows:

UC provides benefits to workers generally after a waiting period of one week of unemployment, provided that each claimant has worked during a base period generally established as the first 4 of the last 5 completed calendar quarters prior to filing the claim. A waiting period is defined as a non-compensable period of unemployment for such acts as leaving voluntarily without good cause, discharge for misconduct connected with work, and refusal of suitable work. The normal benefit will be dependable on the worker's age and weeks of work covered employment in the base period.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES

ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

A. Reporting Entity (Continued)

EB provides benefits for claimants that have exhausted the UC. To be eligible for a work of EB, a claimant must apply for and be able to and available to accept suitable work, if offered. What constitutes suitable work is dependent on a required evaluation of the claimant's employment prospects and as part of this process the claimant must make a "systematic and sustained effort" to seek work and must provide "tangible evidence" that he or she has done so.

**Temporary Non-occupational Disability Insurance Program** – This program consists of a benefit plan for workers. A tax of .6% is levied by the program of which the employer and employee pays .3% each. Taxable amount is limited to the first \$9,000 of the employee's yearly salary. Contributions received under the program are accounted for in the Department's Disability Insurance Fund and are deposited in an interest bearing account to provide for future claims, as established by law.

Disability benefits are provided for a maximum of 26 weeks to workers that have suffered accidents or illness not related to the work place. Disbursements per week will range from \$12 to \$113 and are dependent on the claimant's salary. In order to qualify for benefits, claimants must also comply with certain working time as established in the regulations.

**Drivers' Social Security Insurance Program** – This program provides benefits to workers that use motor vehicles as part of their job duties. The program's benefits include payments to claimants due to death, disability and other benefits to dependents. Funding for the program is provided by a quarterly contribution of eighty cents per employee of which the employer pays thirty cents and fifty cents are paid by the employee. The program's operations are accounted for in the Department's Drivers' Insurance Fund.

Workers claiming benefits under this program must have worked at least 25 weeks prior to any claim related to disability benefits, and at least 10 weeks for death benefits. Benefits payable are calculated in a similar fashion as benefits paid in the disability program, but claimants under the Drivers' Insurance program must be workers that use a motor vehicle as part of their primary job duties.

Taxes and contributions of all programs are due the next day following the levy date, although a 30 day grace period is provided. All of the above taxes and contributions are recognized as operating revenue in the corresponding enterprise fund.

The accompanying enterprise funds' basic financial statements of the Department have been prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP) as prescribed by the Governmental Accounting Standards Board (GASB). The enterprise funds' basic financial statements of the Department are presented as of June 30, 2011, and for the fiscal year then ended. Such enterprise funds' basic financial statements do not purport to, and do not present fairly the financial position of the Department as of June 30, 2011, and the changes in its financial position, or where applicable its cash flows for the year then ended in conformity with US GAAP.

COMMONWEALTH OF PUERTO RICO  
DEPARTMENT OF LABOR AND HUMAN RESOURCES

ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. 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.

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation

**Enterprise Funds Financial Statements** – The financial statements of the enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting.

Each enterprise fund has the option under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, to elect and apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless these conflict with GASB pronouncements. The Department's enterprise funds have elected not to apply FASB pronouncements issued after November 30, 1989.

Enterprise funds distinguish between operating revenue and expenses from nonoperating items. Operating revenue and expenses generally result from providing services in connection with an enterprise fund's principal ongoing operations. The major operating revenues of the Department are as follows:

- Unemployment Insurance Fund – Amounts for charges made to individual employers for payment of unemployment benefits.
- Disability and Drivers' Insurance Funds – Amounts for charges made to employees and individual employers for benefits payments.

Revenue and expenses not meeting this definition are reported as nonoperating revenue and expenses. The major nonoperating revenues of the Department's enterprise funds are mainly contributions from the federal government under various extended unemployment benefits programs.

**Fund Accounting**

The Department's enterprise funds report its financial position and results of operations in funds, which are considered separate accounting entities. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenses. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with legal, financial, and contractual provisions.

**Enterprise Funds** – These are the funds that account for the operations of the Department's enterprise funds that are financed and operated in a manner similar to private business enterprises, where the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**D. Cash and Cash Equivalents**

Cash accounts of the Department's enterprise funds as presented in the accompanying statement of net assets are mainly held by the Department of Treasury of the Commonwealth of Puerto Rico (PR Treasury). All disbursements of the Department's enterprise funds are made through the Government Development Bank for Puerto Rico (GDB), an internal service unit of the Commonwealth. GDB maintains separate codes to identify each governmental unit. No collateral was maintained for cash accounts in GDB as of June 30, 2011. The Department's enterprise funds consider currency on hand, demand deposits and highly liquid investments (including restricted cash purchased with a maturity of three months or less) to be cash equivalents.

Cash balances not held at GDB are controlled by various special collector officials and deposited in qualified depositories. Under the Commonwealth's statutes, public funds deposited in commercial banks 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 PR Treasury.

The Puerto Rico Unemployment Insurance Trust Fund is maintained to account for the collection of unemployment insurance contributions from employers and the payment of unemployment benefits to eligible claimants. As required by federal law, all resources not necessary for current benefit payments are placed on deposit in UTF of the US Treasury. Interest earned over such deposit is retained in the fund.

**E. Restricted Investments**

Restricted investments include US Government and agencies' obligations, mortgage backed securities, and corporate debt and equities. Investment securities are presented at fair value. Changes in the fair value of investments are presented as investment earnings in the statement revenue, expenses, and changes in fund net assets – enterprise funds. Fair value is determined based on quoted market prices. When securities are not listed on national exchanges, quotations are obtained from brokerage firms.

**F. Receivables**

Unemployment, disability and drivers' insurance receivables in the enterprise funds are stated net of estimated allowance for uncollectible accounts, which are determined based upon past collection experience. Intergovernmental receivables primarily represent amounts owed to the Department's Unemployment Insurance Fund for reimbursement of expenditures incurred pursuant to the federally funded programs.

**G. Restricted Assets**

Funds set aside for specified purposes are classified as restricted assets, since their use is limited for a specific purpose by applicable agreements or required by law. Restricted assets in the enterprise funds mainly include amounts set aside for the payment of unemployment and disability insurance benefits.

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**ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**H. Capital Assets**

Capital assets are computer equipment and software stated at cost less accumulated depreciation. The Department defines capital assets as assets that have an initial individual cost of \$25,000 or more at the date of acquisition and have a useful life of five or more years. Such assets are recorded at historical cost or at estimated historical cost if actual historical cost is not available. Donated capital assets are recorded at fair market value at the time of donation. Costs of maintenance and repairs that do not improve or extend the lives of the respective assets are charged to expense as incurred.

Computer equipment and software are depreciated using the straight-line basis over the estimated useful lives estimated at five years. As of June 30, 2011, capital assets amounted to \$187,305, which were fully depreciated.

The Department's enterprise funds follow the provisions of GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries – an amendment of GASB Statement No. 34*. This statement establishes guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries.

**I. Deferred Revenue**

Deferred revenue arises only when resources are received before the Department's enterprise funds has a legal claim to them. In subsequent periods, when the Department's enterprise funds have a legal claim to the resources, the liability for deferred revenue is removed from the statement of net assets and revenue is recognized.

**J. Benefits Payable**

Benefits payable arise from participants' insurance benefit claims of the unemployment, disability and drivers' insurance programs in the enterprise funds. Liabilities for incurred but unpaid benefits and for benefit adjustment expenses are based on the ultimate cost of settling the benefits. Insurance benefit claim liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The insurance benefits liability is reported as a current liability in the accompanying statement of net assets – enterprise funds.

**K. Long-term obligations**

The liabilities reported include the Department's enterprise funds due to other governmental entities and compensated absences obligations (vacation and sick leave).

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ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

L. Compensated Absences

The Department's employees accumulate vacation leave at a rate of 2.5 days per month up to a maximum of 60 days. Unpaid vacation time accumulated is fully vested to the employees from the first day of work. The Department's employees accumulate sick leave at a rate of 1.5 days per month up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated and unpaid sick leave at the current rate, if the employee has at least 10 years of service with the Commonwealth. Accrued compensated benefits are accrued when incurred in the enterprise funds financial statements, when the employee meets such criteria. Such compensated benefits accrual also includes related estimated payroll taxes.

The "Public Service Personnel Law" requires the Department's enterprise funds to pay annually the accumulated vacation and sick leave earned in excess of the limits mentioned above.

M. Interfund and Intraentity Transactions

The Department's enterprise funds have the following types of transactions among funds:

*Interfund Transfers* — Legally required transfers that are reported when incurred as transfer-in by the recipient fund and as transfer-out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds.

*Intraentity Transactions* — Are resource flows between the Department's enterprise funds and the Department's governmental funds and the Commonwealth's discretely presented component units. These resource flows and related outstanding balances are reported as if they were external transactions.

N. Risk Management

The Commonwealth carries commercial insurance to cover property and casualty, theft, tort claims and other losses for the Department. Insurance policies are negotiated by the PR Treasury and costs are allocated among all the governmental units of the Commonwealth. Cost of insurance allocated to the Department's enterprise funds and reimbursed to the PR Treasury amounted to approximately \$64,200, \$36,800, and \$31,900 for the fiscal years ended June 30, 2011, 2010 and 2009, respectively. The current insurance policies have not been cancelled or terminated.

For workmen's compensation, the State Insurance Fund Corporation, a component unit of the Commonwealth, provides workmen's compensation insurance to cover all Department employees. The Department's enterprise funds' workmen's compensation insurance expenses amounted to approximately \$228,100, \$247,100, and \$583,600 for the fiscal years ended June 30, 2011, 2010 and 2009, respectively. In the past three years, the Department has not settled claims that exceed insurance coverage.

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

O. Use of Estimates

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

P. New Accounting Standard Adopted

The following new accounting standard was adopted by the Department's enterprise funds effective July 1, 2010:

- 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. Statement No. 59 includes the following guidance:
  - Emphasizes the applicability of U.S. Securities and Exchange Commission requirements to certain external investment pools — known as a 2a7-like pools — to provide users more consistent information on qualifying pools.
  - Addresses the applicability of Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, to certain financial instruments to clarify which financial instruments are within the scope of that pronouncement and to provide greater consistency in financial reporting.
  - Applies the reporting provisions for interest-earning investment contracts of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, to unallocated insurance contracts to improve the consistency of reporting by pension and OPEB plans.

Adoption of above statement did not have a material impact on the Department's enterprise funds' basic financial statements.

Q. Future Adoption of Accounting Pronouncements

The GASB has issued the following governmental accounting standards that have effective date after June 30, 2011:

- GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. This Statement addresses issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple employers other postemployment benefit (OPEB) plans. The provisions of this Statement related to the use and reporting of the alternative measurement method are effective immediately. The provisions related to the frequency and timing of measurements are effective for actuarial valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. Earlier application of this Statement is encouraged.

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FOR THE YEAR ENDED JUNE 30, 2011

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Q. Future Adoption of Accounting Pronouncements (Continued)

- 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: 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 (ii) the operator collects and is compensated by fees from third parties. The requirements of this Statement are effective for periods beginning after December 15, 2011.
- 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. This statement is effective for periods beginning after June 15, 2012.
- 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: (i) FASB Statements and Interpretations; (ii) Accounting Principles Board Opinions; and (iii) Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. This Statement also supersedes Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. The requirements of this Statement are effective for periods beginning after December 15, 2011.
- 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. 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 periods beginning after December 15, 2011.

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FOR THE YEAR ENDED JUNE 30, 2011

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NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Q. Future Adoption of Accounting Pronouncements (Continued)

- Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of swap counterparty or 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.

The impact of these statements on the Department's enterprise funds' basic financial statements has not yet been determined. However, adoption of these statements is not expected to have a material impact on the Department's enterprise funds' basic financial statements.

NOTE 2 — RESTATEMENTS

Subsequent to the issuance of the Department's enterprise funds' basic financial statements for the year ended June 30, 2010, the Department's management determined that the Department's enterprise funds' 2010 basic financial statements were misstated. The Department's enterprise funds' financial statements were misstated as a result of the following:

- Special disbursement account for administrative expenses not excluded.
- Interfund interest receivable not recorded.
- Understatement of intergovernmental receivables.
- Interfund payables not recorded.
- Intergovernmental payables not recorded.
- Deferred revenues not recorded.
- Understatement of compensated absences due to miscalculation.
- Employees' Christmas Bonus not recorded.
- Early retirement plan costs not recorded.
- Understatement of benefits payable due to miscalculation.
- Unrecorded insurance premiums collections.
- Prior year unrecorded liabilities.
- Prior year duplicated due to other governmental entities accrual.

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**ENTERPRISE FUNDS  
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011**

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**NOTE 2 — RESTATEMENTS (CONTINUED)**

The net assets of the Department's enterprise funds as of June 30, 2010, in the statement of revenues, expenses and changes in fund net assets – enterprise funds, as previously reported, have been restated to reflect a decrease of \$24,508,751, which represent the correction of the errors previously described. A summary of the effects of the restatements in the statement of revenues, expenses and changes in fund net assets – enterprise funds for the fiscal year 2010 is as follows:

	Unemployment Insurance	Disability Insurance	Drivers' Insurance	Total Enterprise Funds
<b>NET ASSETS - Beginning of the year, as previously reported</b>	<b>\$ 309,659,205</b>	<b>\$ 84,443,394</b>	<b>\$ 32,249,994</b>	<b>\$ 426,352,593</b>
<b>ADJUSTMENTS:</b>				
Cash reconciling items from prior year recorded twice	876,344	-	-	876,344
Special Disbursement Officer account for administrative expenses	239,674	-	-	239,674
Interfund interest receivable not recorded	-	-	238,576	238,576
Understatement of intergovernmental receivable	75,037	-	-	75,037
Interfund payables not recorded	(5,448,173)	-	-	(5,448,173)
Intergovernmental payables not recorded	(223,745)	-	-	(223,745)
Deferred revenues not recorded	(525,422)	(2,449,242)	-	(2,974,664)
Understatement of compensated absences due to miscalculation	-	(703,652)	(497,367)	(1,201,019)
Employees' Christmas bonus not recorded	-	-	(82,396)	(82,396)
Early retirement pension plan obligation not recorded	-	(1,554,445)	(805,970)	(2,360,415)
Understatement of benefits payable due to miscalculation	(13,855,672)	-	-	(13,855,672)
Unrecorded insurance premiums collections	-	185,189	-	185,189
Prior year unrecorded liabilities	-	(226,871)	-	(226,871)
Prior year duplicated due to other governmental entities accrual	-	249,384	-	249,384
<b>Total adjustments</b>	<b>(18,861,957)</b>	<b>(4,499,637)</b>	<b>(1,147,157)</b>	<b>(24,508,751)</b>
<b>NET ASSETS - Beginning of the year, as restated</b>	<b>\$ 290,797,248</b>	<b>\$ 79,943,757</b>	<b>\$ 31,102,837</b>	<b>\$ 401,843,842</b>

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 3 — CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of demand deposits, interest bearing accounts and short-term investments. The carrying amount of deposits of the Department's enterprise funds at June 30, 2011 consists of the following:

	Carrying Amount			Depository Bank Balance	Amount Uninsured and Uncollateralized
	Unrestricted	Restricted	Total		
Commercial bank	\$ 61,036	\$ 1,343,582	\$ 1,404,618	\$ 931,766	\$ -
Governmental bank	12,363,257	15,851,410	28,214,667	19,750,992	19,750,992
US Treasury	-	339,666,242	339,666,242	339,666,242	-
	<u>\$ 12,424,293</u>	<u>\$ 356,861,234</u>	<u>\$ 369,285,527</u>	<u>\$ 360,349,000</u>	<u>\$ 19,750,992</u>

Custodial credit risk is the risk that in the event of bank failure, the Department's enterprise funds' deposits might not be recovered. 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 banks in the Commonwealth's name. There is no formal policy for custodial credit risk for cash accounts with commercial banks outside Puerto Rico.

The Department's enterprise funds' bank balance in commercial bank was covered by federal depository insurance or by collateral held by Secretary of the PR Treasury in the Commonwealth's name. The amounts deposited in the GDB are uninsured and uncollateralized. Such deposits are exempt from the collateral requirement established by the Commonwealth and thus represent a custodial credit risk, because in the event of GDB's failure, the Department may not be able to recover these deposits. The deposits with the US Treasury from unemployment insurance taxes in the UTF can only be invested in obligations of the US or obligations guaranteed by the US.

In addition, the Department's enterprise funds have deposits that are held by the PR Secretary of Treasury (as fiscal agent of the Department). These amounts are uninsured and uncollateralized since deposited in the GDB.

The Drivers' Insurance interest bearing account in the GDB is pledged as collateral to the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS) for amounts due under the early retirement program of July 2008.

Cash and cash equivalents in governmental bank - restricted in the Unemployment Insurance Fund currently includes balances of two special disbursement officer's (SDO) accounts: one for unemployment benefits payments and the other for work opportunity incentive payments. The GASB No. 34, Basic Financial Statements and Management's Discussion and Analysis-for State and Local Governments, provides that administrative costs related to the unemployment insurance should be included in the general fund unless legal provisions require it to be reported in another fund. The SDO cash balance that consistently with GASB 34 should have been transferred since June 30, 2002 to the Work Opportunity Incentive Fund (included as a governmental fund of the Department) has not been determined nor adjusted in the accompanying basic financial statements.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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NOTE 4 — RESTRICTED INVESTMENTS

As required by law, the principal purpose of the Disability and Drivers' Insurance funds is to cover payments for benefits claimed. To comply with the obligations of such enterprise funds, aside from the insurance premiums collections, an adequate investment of the required reserves is necessary to ensure the solvency of these enterprise funds. Accordingly, the results from the investments are a critical element to achieve the objectives and obligations imposed by law.

The Department's investment policies for such enterprise funds establish limitations and other guidelines on amounts to be invested in the investment categories and by issuer/counterparty and on exposure by country. Such policies provide guidelines on the institutions with which investment transactions can be entered into. In addition, the investment committee and the Secretary of the Department will determine, from time to time, other transactions that such enterprise funds may enter into.

*Inherent rate risk* — In accordance with its investment policy, the Disability Insurance Fund manages its exposure to declines in fair values by establishing a long-term maturity of the investment portfolio of more than five years.

*Credit risk* — The Department's investment policy for the Disability Insurance Fund is to limit its investments pool rating of obligations and equities, not guaranteed by the US or its agencies, to not less than AAA by the Standard and Poor's (S&P) or Aaa by the Moody's Investors Service (Moody's) and of corporate debt securities to the top three ratings by the S&P and Moody's.

*Concentration of credit risk* — The Department's investment policies for the Disability Insurance Fund does not allow for investment in debt securities in excess of 20% of the Department's enterprise funds fixed income investments and in small companies' equities in excess of 50% of the total equities investments.

*Custodial credit risk* — The risk that, in the event of the failure of the counterparty to the transaction, the Department's Disability Insurance Fund may not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. At June 30, 2011, securities investments were registered in the name of the Commonwealth and were held in the possession the Commonwealth's custodian bank.

*Foreign currency risk* — The Department's investment policy for the Disability Insurance Fund limits the investment in emerging countries to 50% of the total international equities.

All of the Department's investments of the Disability Insurance Fund in US Treasury securities and mortgage-backed securities guaranteed by Government National Mortgage Association (GNMA) carry the explicit guarantee of the US government and are presented as AAA to A- in the credit risk tables.

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NOTE 4 — RESTRICTED INVESTMENTS (CONTINUED)

The fair value by investment type, credit quality ratings and maturity of the restricted investments reported by the enterprise funds at June 30, 2011 consist of the following:

	Fair Value	Investment Rating			
		AAA to A	BBB to BB	Not Rated	No Risk
Mortgage-backed securities	\$ 9,639,874	\$ 2,820,935	\$ -	\$ 1,633,514	\$ 5,185,425
U.S. government and agency securities	2,827,666	669,283	-	56,267	2,102,116
U.S. equity securities	13,547,990	-	-	13,547,990	-
U.S. corporate debt securities	6,278,782	4,689,826	1,588,956	-	-
Other	2,862,942	794,126	-	2,068,816	-
Total	<u>\$ 35,157,254</u>	<u>\$ 8,974,170</u>	<u>\$ 1,588,956</u>	<u>\$ 17,306,587</u>	<u>\$ 7,287,541</u>

	Fair Value	Maturity (In Years)			
		No Stated Maturity	1 to 5 Years	6 to 10 Years	More Than 10 Years
Mortgage-backed securities	\$ 9,639,874	\$ 65,025	\$ 1,561,350	\$ 644,473	\$ 7,369,026
U.S. government and agency securities	2,827,666	-	1,006,517	110,950	1,710,199
U.S. equity securities	13,547,990	13,547,990	-	-	-
U.S. corporate debt securities	6,278,782	-	2,236,097	2,596,728	1,445,957
Other	2,862,942	2,068,816	217,038	577,088	-
Total	<u>\$ 35,157,254</u>	<u>\$ 15,681,831</u>	<u>\$ 5,021,002</u>	<u>\$ 3,929,239</u>	<u>\$ 10,525,182</u>

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**NOTE 5 — RECEIVABLES**

Receivables in the Department's enterprise funds at June 30, 2011 include approximately **\$55,450,900** of unemployment, disability, and drivers' insurance premium receivable, including insurance interest receivable as follows:

	<u>Unemployment Insurance</u>	<u>Disability Insurance</u>	<u>Drivers' Insurance</u>	<u>Total Enterprise Funds</u>
Insurance premiums	\$ 559,138,918	\$ 27,133,923	\$ 1,115,608	\$ 587,388,449
Accrued insurance interest	38,306,286	3,287,841	-	41,594,127
Subtotal	597,445,204	30,421,764	1,115,608	628,982,576
Less: Allowance for doubtful accounts	545,965,107	27,511,617	54,974	573,531,698
Insurance premiums and accrued interest, net	<u>\$ 51,480,097</u>	<u>\$ 2,910,147</u>	<u>\$ 1,060,634</u>	<u>\$ 55,450,878</u>

Insurance tax premiums are levied each quarter to employers registered under the State Unemployment Insurance, the Temporary Non-occupational Disability Insurance and the Driver's Social Security Insurance Programs. The Unemployment Insurance Program has receivables from private employers, governmental entities of the Commonwealth, and municipalities, of approximately \$456,687,400, \$124,821,500 and \$15,936,300, respectively.

In addition, receivables in the Department's enterprise funds include intergovernmental receivables from the federal government of approximately **\$845,300** and other miscellaneous. Federal contributions are received to reimburse the benefits paid mainly for extended unemployment benefits granted under the Emergency Unemployment Compensation and the Additional Unemployment Compensation programs and to unemployed ex-military and civilian ex-federal employees, whose unemployment is caused by a presidential declared disaster under the Disaster Relief Act, and adversely affected work under the Trade Act.

**NOTE 6 — PAYABLES**

Payables in the Department's enterprise funds include approximately **\$611,900** of trade accounts due to suppliers for purchase of merchandise and services rendered and approximately **\$209,300** of accrued Christmas bonus at June 30, 2011.

Benefits payable in the enterprise funds include approximately **\$86,338,200** of unemployment, disability, and drivers' insurance benefits claims.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 7 — INTERFUND AND INTRAENTITY TRANSACTIONS**

Interfund receivables and payables at June 30, 2011 consist of:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
Drivers' Insurance	General Fund	\$ 20,798,105
General Fund	Unemployment Insurance	16,729,044
General Fund	Disability Insurance	803,395
		<u>\$ 38,330,544</u>

Transfers from/to other funds for the year ended June 30, 2011 are as follows:

<u>Transferee Fund</u>	<u>Transferor Fund</u>	<u>Purpose</u>	<u>Amount</u>
General Fund	Unemployment Insurance	Cash for work incentives and administrative expenses payments	\$ 43,091,727
General Fund	Unemployment Insurance	Cash for administrative expenses payments	8,112,949
General Fund	Disability Insurance	Cash for work opportunity incentive payments	1,000,000
General Fund	Disability Insurance	Surplus cash for administrative expenses payments	2,146,789
General Fund	Drivers' Insurance	Surplus cash for administrative expenses payments	97,384
			<u>\$ 54,448,849</u>

The principal purpose of the interfund transfers was the unemployment and disability insurance funds' distribution of cash belonging to the general fund for payment of work opportunity incentives and administrative expenses amounting to \$52,204,676, as required by law.

Interfund receivables and payables of the Department's enterprise funds represent pending settlements of the aforementioned transfers or transactions from current and prior years.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
FOR THE YEAR ENDED JUNE 30, 2011**

**NOTE 7 — INTERFUND AND INTRAENTITY TRANSACTIONS (CONTINUED)**

Due from/to other governmental entities by the Department's enterprise funds at June 30, 2011 consist of:

<u>Receivable Entity/Fund</u>	<u>Payable Entity/Fund</u>	<u>Amount</u>
Drivers' Insurance	State Insurance Fund Corporation	\$ 9,228
Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities	Disability Insurance	410,730
Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities	Drivers' Insurance	212,961
Public Buildings Authority	Drivers' Insurance	4,950
Puerto Rico Electric Power Authority	Disability Insurance	66,994
Puerto Rico Electric Power Authority	Drivers' Insurance	21,487
Puerto Rico Aqueduct and Sewer Authority	Disability Insurance	369
Puerto Rico Aqueduct and Sewer Authority	Drivers' Insurance	426
		<u>\$ 727,145</u>

Expenses in the enterprise funds include approximately \$995,200 in contributions made by the Department's enterprise funds to the Commonwealth's component units as follows:

<u>Component Unit</u>	<u>Amount</u>
Puerto Rico Electric Power Authority	\$ 185,245
Puerto Rico Aqueduct and Sewer Authority	13,766
Public Buildings Authority	29,686
State Insurance Fund Corporation	228,129
Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities	<u>538,333</u>
	<u>\$ 995,159</u>

**NOTE 8 — RESTRICTED ASSETS**

Restricted assets included in the enterprise funds' basic financial statements as of June 30, 2011 consist of restricted cash and investments held for unemployment and disability insurance benefits payments amounting to approximately **\$392,018,500**.

Liabilities payable from restricted assets included in the enterprise funds' basic financial statements as of June 30, 2011 consist of unemployment and disability insurance benefits payable amounting to approximately **\$86,215,100**.

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**NOTE 8 — RESTRICTED ASSETS (CONTINUED)**

Restricted net assets included in the enterprise funds' basic financial statements as of June 30, 2011 consist of net assets for payment of unemployment and disability insurance benefits amounting to approximately \$330,925,400.

**NOTE 9 – LONG-TERM LIABILITIES**

Long-term liability activity of the Department's enterprise funds for the fiscal year ended June 30, 2011 was as follows:

	<u>Beginning Balance as Restated</u>	<u>Net Increases (Decreases)</u>	<u>Ending Balance</u>	<u>Due within one year</u>	<u>Long-term portion</u>
Compensated absences	\$ 2,046,437	\$ 66,512	\$ 2,112,949	\$ 883,859	\$ 1,229,090
Due to other governmental entities	<u>1,382,624</u>	<u>(664,707)</u>	<u>717,917</u>	<u>468,441</u>	<u>249,476</u>
<b>Total</b>	<u>\$ 3,429,061</u>	<u>\$ (598,195)</u>	<u>\$ 2,830,866</u>	<u>\$ 1,352,300</u>	<u>\$ 1,478,566</u>

Compensated absences and due to other governmental entities reflect net increases (decreases) resulting from adjustments and changes to agree these obligations to their new estimated balances at June 30, 2011.

**Compensated Absences**

Long-term debt includes approximately \$2,113,000 of accrued vacation and sick leave benefits at June 30, 2011. The total liability of compensated absences recorded in the Disability's Insurance Fund and the Driver's Insurance Fund amounted to \$1,289,321 and \$823,628, respectively.

**Due to Other Governmental Entities**

Long-term debt includes approximately \$623,700 of accrued pension plan contributions at June 30, 2011 related to the Department's early retirement plan of July 2008. The total liability of unpaid contributions recorded as due to other governmental entities in the Disability's Insurance Fund and the Driver's Insurance Fund amounted to \$410,730 and \$212,961, respectively. The long-term portion is payable on July 31, 2012.

**NOTE 10 — RETIREMENT SYSTEM**

All employees of the Department are eligible to and participate in a contributory pension plan known as, the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities (ERS), sponsored by the Commonwealth.

The ERS is independent, thus assets may not be transferred to another system or used for any purpose other than to benefit each system's participants.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 10 — RETIREMENT SYSTEM (CONTINUED)**

The Department's enterprise funds follow the provisions of GASB No. 27, Accounting for Pensions by State and Local Governmental Employers, which requires employers that participate in cost-sharing multi-employer defined-benefit pension plans to recognize pension expenditures/expense equal to the employer's contractually required contributions and a liability for unpaid contributions.

**ERS Defined Benefit Pension Plan**

The ERS is a cost-sharing multi-employer defined benefit plan sponsored by the Commonwealth under the terms of Act 447 of 1951, as amended, reported as a component unit of the Commonwealth. Participation is optional for employees hired before January 1, 2000 and under 55 years of age at the date of employment. No benefits are payable if the participant receives a refund of their accumulated contributions.

The ERS defined benefit pension plan provides retirement, death and disability benefits. Death and disability retirement benefits are available to members for occupational and nonoccupational death and disabilities. Retirement benefits depend upon age at retirement and number of years of credited service. Benefits vest after 10 years of plan participation. Disability benefits are available to members for occupational and nonoccupational disabilities. However, a member must have at least 10 years of service to receive nonoccupational disability benefits.

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.

Act 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 service, 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 service.

**ERS Defined Contribution Pension Plan**

Act 335 of September 24, 1999, an amendment to Act 447 of May 15, 1951, which created the ERS, was enacted with the purpose of establishing a new pension program (System 2000). System 2000 became effective on January 1, 2000. Employees participating in the current system as of December 31, 1999, may elect either to stay in the defined benefit plan or irrevocably transfer to the new program. Employees joining the government on or after January 1, 2000 will only be allowed to become members of System 2000.

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NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)  
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**NOTE 10 — RETIREMENT SYSTEM (CONTINUED)**

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 ERS, together with those of the current defined benefit plan. Benefits at retirement age will not be guaranteed by the Commonwealth. The annuity will be based on a formula which assumes that each year the employees' contribution (with a minimum of 8.275% of the employees' salary up to a maximum of 10%) will be invested in an account which will either: (1) earn a fixed rate based on the two-year Constant Maturity Treasury Note; (2) earn a rate equal to 75% of the return of the ERS's investment portfolio (net of management fees); or (3) 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 employer's contributions (9.275% of the employee's salary) will be used to fund the current plan.

System 2000 reduces the retirement age from 65 years to 60 for those employees who joined the current plan or after January 1, 2000.

Total Department's enterprise funds' employee contributions to the ERS Defined Benefit Pension Plan and the ERS Defined Contribution Pension Plan during the fiscal year ended June 30, 2011 amounted to approximately \$343,500 and \$194,800, respectively. The Department's enterprise funds' contributions during the fiscal years ended June 30, 2011, 2010 and 2009 amounted to approximately \$1,055,100, \$1,654,500, and \$2,233,600, respectively. These amounts represented 100% of the Department's enterprise funds required contribution for the corresponding year. Individual information for each option is not available since the allocation is performed by the ERS itself.

**Early Retirement Program**

The Department implemented an early retirement program for its employees under Act 136 dated July 29, 2008. The incremental costs of the early retirement program of the Disability and Drivers' insurance funds amounted to approximately \$3 million. The Department's enterprise funds already made three payments and would reimburse the remaining balance on annuities and other benefits paid by the ERS in two installments on each July 31 through 2012.

Additional information on the ERS is provided in its financial statements for the fiscal year ended June 30, 2011, a copy of which can be obtained from the Employees' Retirement System of the Commonwealth of Puerto Rico and its Instrumentalities, PO Box 42003, San Juan, PR 00940-2003.

**NOTE 11 – COMMITMENTS**

The Department has several non-cancelable operating leases, including those with the Public Buildings Authority of the Commonwealth of Puerto Rico, primarily for regional Department's facilities that expire over minimum terms of five years, and can be renewed for additional terms, as provided in each contract. For the years ended June 30, 2011, 2010 and 2009, rent expenses of the Department's enterprise funds amounted to approximately \$544,200, \$439,600, and \$198,800, respectively, under such operating leases.

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NOTE 11 – COMMITMENTS (CONTINUED)

The future minimum lease payments of the Department's enterprise funds for these leases are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2012	\$ 573,920
2013	543,608
2014	518,460
2015	518,460
2016	143,312
2017-2021	114,997
2022-2026	<u>22,999</u>
Total future minimum lease payments	<u>\$ 2,435,756</u>

NOTE 12— CONTINGENCIES

Litigations

The Department is defendant or co-defendant in various pending litigations. The Department's management, after consultation with in house legal counsel, has determined that the probable outcome of these cases will not have a material impact on the accompanying enterprise funds' basic financial statements. The Commonwealth of Puerto Rico Act 104 of June 30, 1955, as amended, known as Claims and Lawsuits against the State, provides that lawsuits initiated against an agency or instrumentality of the Commonwealth, present and former employees, directors, mayors, and others may be represented by the Department of Justice of the Commonwealth of Puerto Rico. Any adverse claim to the defendants is to be paid by the General Fund of the Commonwealth. However, the Secretary of the PR Treasury has discretion of requesting reimbursement of the funds expended for these purposes from public corporations, governmental institutions and municipalities of the defendants.

Federal Awards

The Department participates in federal programs received from the US DOL to promote the working class welfare and to finance the administration costs of the State Unemployment Insurance Program. Expenditures financed by federal grants are subject to program compliance audits by the grantor agencies in order to assure compliance with grant requirements. If expenditures are disallowed due to noncompliance with grant program requirements, the Department may be required to reimburse the grantor agency. Accordingly, the Department's compliance with applicable grant requirements will be established at a future date. Nevertheless, the Department's management is of the opinion that the amount of expenditures, which may be disallowed by the granting agencies from such audits, will be immaterial to the Department's enterprise funds' basic financial statements.

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**NOTE 13— SUBSEQUENT EVENTS**

The date to which events occurring after June 30, 2011 have been evaluated is February 21, 2012, which is the date the Department's enterprise funds' basic financial statements were available to be issued.