SENADO
ESTADO LIBRE ASOCIADO DE PUERTO RICO

Secretaría

LCDA. TANIA BARBAROSSA ORTIZ

- [ ] VER AL DORSO
- [ ] NOTAS
- [ ] PARA CALENDARIO
- [ ] TRAER EXPEDIENTE
- [x] DAR CUENTA
- [ ] REGISTRAR Y PROCESAR
- [ ] ARCHIVAR
- [ ] PREPARAR CARTA
- [ ] NOMBRAMIENTO
- [ ] AUTORIZADO Y GESTIONAR

EL CAPITOLIO
PO BOX 9023431
SAN JUAN, PUERTO RICO
00902-3431

INICIALES

REFERIDO A:

COMISIONES PERMANENTES

- [ ] HACIENDA Y FINANZAS PÚBLICAS
- [ ] GOBIERNO, EFICIENCIA GUBERNAMENTAL E INNOVACIÓN ECONÓMICA
- [ ] JURIDICA, SEGURIDAD Y VETERANOS
- [ ] SALUD Y NUTRICIÓN
- [ ] EDUCACIÓN, FORMACIÓN Y DESAROLLO DEL INDIVIDUO
- [ ] ASUNTOS DE LA MUJER
- [ ] INFRASTRUCTURA, DESAROLLO URBANO Y TRANSPORTACIÓN
- [ ] AGRICULTURA, SEGURIDAD ALIMENTARIA Y SUSTENTABILIDAD DE LA MONTAÑA
- [ ] RECURSOS NATURALES, AMBIENTALES Y ASUNTOS ENERGÉTICOS
- [ ] COOPERATIVISMO, PEQUEÑAS Y MEDIANAS EMPRESAS Y MICRO-EMPRESAS
- [ ] TURISMO, CULTURA, RECREACIÓN Y DEPORTES Y GLOBALIZACIÓN
- [ ] RELACIONES LABORALES, ASUNTOS DEL CONSUMIDOR Y CREACIÓN DE EMPLEOS
- [ ] DERECHOS CIVILES, PARTICIPACIÓN CIUDADANA Y ECONOMÍA SOCIAL
- [ ] AUTONOMÍA MUNICIPAL, DESCENTRALIZACIÓN Y REGIONALIZACIÓN
- [ ] BANCA, SEGUROS Y TELECOMUNICACIONES
- [ ] VIVIENDA Y COMUNIDADES SOSTENIBLES
- [ ] ÉTICA E INTEGRIDAD LEGISLATIVA
- [ ] CORPORACIONES PÚBLICAS Y ALIANZAS PÚBLICO-PRIVADAS
- [ ] REGLAS, CALENDARIO Y ASUNTOS INTERNOS

RSM ROC & Company
Certified Public Accountants & Consultants

RSM ROC & Company
PO Box 10528
San Juan, PR 00922-0528
T: 787 751 6164 F: 787 759 7479
www.rocpr.net

INDEPENDENT AUDITORS' REPORT

To: The Members of the Board of Directors of
The Children's Trust

We have audited the accompanying financial statements of The Children's Trust, a Component Unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise the entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of The Children's Trust as of June 30, 2013, and the respective changes in financial position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 7 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 response to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

San Juan, Puerto Rico
December 10, 2013.

RSM ROC y Company

Stamp No. E83610 was affixed to
the original of this report.

As management of the Children's Trust (the "Trust"), we offer readers of the Trust's financial statements this narrative overview and analysis of the Trust's financial performance during the fiscal year ended June 30, 2013. Please read it in conjunction with the Trust's basic financial statements including the notes thereto, which follow this section.

1. FINANCIAL HIGHLIGHTS

- The Trust's government-wide net deficiency decreased by approximately $14.2 million to approximately $1,161 million as of June 30, 2013, or approximately 1.2%, from an approximately $1,175 million as of June 30, 2012.

- Government-wide revenues from the Global Settlement Agreement for the fiscal year 2013 amounted to approximately $109.4 million, an increase of approximately $36.9 million, or approximately 51%, from fiscal year 2012 of approximately $72.5 million.

- The Trust's operating expenses consist of payments for programs and activities permitted by the enabling legislation. Funds granted during 2013 accounted in the government-wide financials totaled approximately $6.9 million, an increase of approximately $3.1 million, or approximately 46%, from approximately $3.7 million granted during 2012.

2. OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements include the management's discussion and analysis section, the independent auditors' report, and the basic financial statements of the Trust. The basic financial statements also include notes that explain in more detail some of the information in the basic financial statements.

3. REQUIRED FINANCIAL STATEMENTS

Government-Wide Financial Statements — The statement of net deficit and the statement of activities report information on all activities of the Trust. Only governmental activities are presented in the Trust's financial statements. Governmental activities generally are financed through nonexchange revenues. Following is a description of the Trust's government-wide financial statements.

- The statement of net deficit presents the Trust's assets and liabilities, with the difference reported as net deficit.

- The statement of activities demonstrates the degree to which the direct expenses of a given function or segments are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include: (1) interest income on investments and interest-bearing deposits, (2) grants and contributions that are restricted to meet the operational or capital requirements of a particular function. Other items not meeting the definition of program revenues are reported as general revenues.

Fund Financial Statements — Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts that comprise its assets, liabilities, fund balances, revenues and expenditures, as appropriate. The financial activities of the Trust reported in the accompanying basic financial statements were classified into governmental funds. All funds of the Trust are major funds.

4. FINANCIAL ANALYSIS

The statement of net deficit and the statement of activities report information about the Trust's activities in a way that will help understand if the Trust as a whole is better or worse as a result of this year activities. These two statements report the net deficit of the Trust and the changes in net deficit for the year.

One can think of the Trust's net deficit — the difference between assets and liabilities — as one way to measure financial health or financial position. Over time, increases or decreases in the Trust's net deficit are one indicator of whether its financial health is improving or deteriorating. However, other non-financial factors on tobacco and general industries, as are changes in economic conditions and government legislations need to be considered.

5. GOVERNMENT-WIDE FINANCIAL ANALYSIS

The government wide financial statements were designed so that the user could determine whether the Trust is in a better or worse financial condition when compared to the prior year. The following is a condensed summary of net deficit of the Trust compared with prior year (in thousands):

	June 30,		Change	
	2013	2012	Amount	Percent
Assets:				
Current assets	$ 37,232	$ 43,696	$ (6,464)	(14.8%)
Non-current restricted assets	159,550	158,973	577	0.4%
Total assets	196,782	202,669	(5,887)	(2.9%)
Liabilities:				
Current liabilities	24,623	22,829	1,794	7.9%
Non-current liabilities	1,332,906	1,354,802	(21,896)	(1.6%)
Total liabilities	1,357,529	1,377,631	(20,102)	(1.5%)
Net deficit	$ (1,160,747)	$ (1,174,962)	$ 14,215	(1.2%)

As noted, the Trust's net deficit decreased by approximately $14.2 million, from a deficit of approximately $1,175 million in 2012 to a deficit of approximately $1,161 million in 2013. This decrease results from the net effect of the decrease in total assets of approximately $5.9 million, mainly resulting from grants disbursements of approximately $6.9 million during the year, and approximately $20.1 million decrease in liabilities, mainly due to the net effect of the amortization of loss on refunded bonds and discount of approximately $4.4 million, the effect of interest capitalization for fiscal year 2013 of approximately $33.4 million, and the payment of principal on bonds of approximately $58 million.

Condensed program net revenues or expenses and change in net deficit are presented below (in thousands):

Function/Programs	Year Ended June 30, 2013	Year Ended June 30, 2012	Change Amount	Change Percent
Governmental activities:				
Education	$ 156	$ 449	$ (293)	(65.3%)
Health	424	1,376	(952)	(69.2%)
Recreation	3,629	1,255	2,374	189.2%
Intergovernmental grants	2,703	660	2,043	309.5%
Interest on long term debt and other - net	88,637	87,609	1,028	1.2%
Total	95,549	91,349	4,200	4.6%
General revenues:				
Investment earnings	35	47	(12)	(25.5%)
Global Settlement Agreement	109,415	72,500	36,915	50.9%
Other income	313	405	(92)	(22.7%)
Total	109,763	72,952	36,811	50.5%
Change in net deficit	$ 14,214	$ (18,397)	$ 32,611	(177.3%)

While comparative statements of net deficit show the changes in financial position, the statement of activities provides answers as to the nature and source of these changes. There is a positive change in net deficit of approximately $14.2 million that is accounted for as follows: 1) a decrease on governmental activities of education and health of approximately $1.2 million, 2) an increase on recreational activities and intergovernmental grants for approximately $4.4 million, 3) a net increase of interest on long term debt and other of approximately $1 million, and 4) an increase on total general revenues for $36.8 million.

The net increase of approximately $519 thousand on governmental activities of education, health, and recreational, and the increase of approximately $2 million on intergovernmental grants was mainly due to the management decision on activities selected for assignments of funds during the year ended June 30, 2013.

The net increase of interest on long term debt and other for approximately $1 million was mainly due to the payments to the bonds payable made during the fiscal year. During the year ended June 30, 2013 and 2012, principal payments on bonds payable were approximately $58 million and $22 million, respectively.

The increase on total general revenues for approximately $36.8 million was mainly due to the increase of the operating contributions for approximately $36.9 million as a result of the increase on the revenues received from the Global Settlement Agreement, net of approximately $100 thousand on other income and investment earnings. Current year other income of approximately $313 thousand represents share of the payment received from the result of a derivative settlement between the Attorneys General Settlement Agreement and GE Funding Capital Market Services, Inc.

6. GOVERNMENTAL FUND FINANCIAL ANALYSIS

The Trust's governmental funds reported fund balances of approximately $146.8 million as of June 30, 2013, which is approximately $7.2 million less than prior year. The decrease in fund balance in the governmental funds is mainly due to grants disbursements of approximately $6.9 million during fiscal year 2013.

The following is a condensed summary of fund balances of the Trust compared with prior year (in thousands) in the governmental funds:

	Year Ended June 30,		Change	
	2013	2012	Amount	Percent
Assets	$ 190,092	$ 195,177	$ (5,085)	(2.6%)
Liabilities	$ 43,342	$ 41,217	$ 2,125	5.2%
Fund balances	146,750	153,960	(7,210)	(4.7%)
Total liabilities and fund balances	$ 190,092	$ 195,177	$ (5,085)	(2.6%)

7. DEBT ADMINISTRATION

During the year ended June 30, 2013, the debt service payments amounted to approximately $57.9 million of its bonds payable, and has a remaining balance of bonds outstanding of approximately $1,350 million, net of approximately $21.9 million of non-accreted bond discount and an unamortized deferred loss on refunded bonds of approximately $27.4 million, due through year 2057.

8. REQUEST FOR INFORMATION

This financial report is designed to provide those interested with a general overview of the Trust's finances and to enhance the Trust's accountability for the funds it receives. Questions about this report or requests for additional information should be addressed to the Trust, PO Box 42001, San Juan, Puerto Rico, 00940-2001.

THE CHILDREN'S TRUST
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF NET DEFICIT
JUNE 30, 2013

	Governmental Activities
ASSETS	
CURRENT ASSETS:	
Interest-bearing deposits with Government Development Bank for Puerto Rico	$ 19,534,289
Cash and cash equivalents	66,808
Investments and investment contracts	17,628,996
Accrued interest receivable	1,606
Total current assets	37,231,699
NONCURRENT RESTRICTED ASSETS:	
Cash held by trustee	10,910
Investments and investment contracts	110,097,307
Accrued interest receivable	441,604
Receivable from Global Settlement Agreement	42,310,674
Deferred bond issue costs, net	6,690,145
Total noncurrent restricted assets	159,550,640
Total assets	196,782,339
LIABILITIES	
CURRENT LIABILITIES:	
Accounts payable	1,031,531
Liabilities payable from restricted assets:	
Accrued interest payable	6,326,569
Bonds payable - due in one year	17,265,000
Total current liabilities	24,623,100
NONCURRENT LIABILITY — Bonds payable - due in more than one year	1,332,906,480
Total liabilities	1,357,529,580
NET DEFICIT	
Restricted	159,550,640
Unrestricted	(1,320,297,881)
Total net deficit	$ (1,160,747,241)

See notes to basic financial statements.

THE CHILDREN'S TRUST
(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2013

		Program Revenues		Net
Functions/Programs	Expenses	Investment Earnings	Operating Contributions	Revenues/(Expenses) and Change in Net Deficit
GOVERNMENTAL ACTIVITIES:				
Education	$ 156,373	$ -	$ -	$ (156,373)
Health	423,928	-	-	(423,928)
Recreation	3,628,805	-	-	(3,628,805)
Intergovernmental grants	2,702,340	-	-	(2,702,340)
Debt service and other	92,019,462	3,382,856	109,414,128	20,777,522
Total governmental activities	$ 98,930,908	$ 3,382,856	$ 109,414,128	13,866,076
GENERAL REVENUES:				
Investment earnings				35,014
Other income				313,282
Total general revenues				348,296
CHANGE IN NET DEFICIT				14,214,372
NET DEFICIT — Beginning of year				(1,174,961,613)
NET DEFICIT — End of year				$ (1,160,747,241)

See notes to basic financial statements.

THE CHILDREN'S TRUST
(A Component Unit of the Commonwealth of Puerto Rico)

BALANCE SHEET — GOVERNMENTAL FUNDS
JUNE 30, 2013

	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS			
Interest-bearing deposits with Government Development Bank for Puerto Rico	$ 19,534,289	$ -	$ 19,534,289
Cash and cash equivalents	66,808	-	66,808
Cash held by trustee	-	10,910	10,910
Investments and investment contracts	17,628,996	110,097,307	127,726,303
Accrued interest receivable	1,606	441,604	443,210
Receivable from Global Settlement Agreement	-	42,310,674	42,310,674
Total assets	$ 37,231,699	$ 152,860,495	$ 190,092,194
LIABILITIES AND FUND BALANCES			
LIABILITIES:			
Accounts payable	$ 1,031,531	$ -	$ 1,031,531
Deferred revenue	-	42,310,674	42,310,674
Total liabilities	1,031,531	42,310,674	43,342,205
FUND BALANCES:			
Restricted	-	110,549,821	110,549,821
Committed	29,041,826	-	29,041,826
Assigned	2,849,918	-	2,849,918
Unassigned	4,308,424	-	4,308,424
Total fund balances	36,200,168	110,549,821	146,749,989
Total liabilities and fund balances	$ 37,231,699	$ 152,860,495	$ 190,092,194

See notes to basic financial statements.

THE CHILDREN'S TRUST
(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF BALANCE SHEET- GOVERNMENTAL FUNDS TO THE STATEMENT OF NET DEFICIT
JUNE 30, 2013

FUND BALANCES OF GOVERNMENTAL FUNDS	$	146,749,989
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES ARE DIFFERENT IN THE STATEMENT OF NET DEFICIT BECAUSE:		
Bond issue costs are reported as an expenditure in the governmental funds financial statements; however, these costs are capitalized and amortized over the life of the bonds and are included in the statement of net deficit.		6,690,145
Receivable from Global Settlement Agreement to be applied to debt service will not be received in the current period, and therefore, is reported as a deferred revenue in the fund financial statements.		42,310,674
Accrued interest payable is not due and payable in the current period and, therefore, is not reported in the fund financial statements.		(6,326,569)
Bonds payable are not due and payable in the current period and, therefore, are not reported in the fund financial statements.		(1,399,631,635)
Discount on bonds issued is reported as an other financing use in the governmental funds financial statements; however, such discount is deferred and accreted over the life of the bonds and is included within bonds payable in the statement of net deficit.		21,969,049
Unamortized loss on bonds refunding is not reported as an expenditure in the governmental fund financial statements; however, such loss is deferred and amortized over the life of the bonds and is included within bonds payable in the statement of net deficit.		27,491,106
NET DEFICIT OF GOVERNMENTAL ACTIVITIES	$	(1,160,747,241)

See notes to basic financial statements.

THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES — GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2013

	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Investment earnings	$ 35,014	$ 3,382,856	$ 3,417,870
Revenue from Global Settlement Agreement	-	107,687,982	107,687,982
Other income	313,282	880	314,162
Total revenues	348,296	111,071,718	111,420,014
EXPENDITURES:			
Education	156,373	-	156,373
Health	423,928	-	423,928
Recreation	3,628,805	-	3,628,805
Intergovernmental	2,702,340	-	2,702,340
Other	299,959	-	299,959
Debt service:			
Principal	-	57,935,000	57,935,000
Interest	-	53,483,316	53,483,316
Total expenditures	7,211,405	111,418,316	118,629,721
NET CHANGE IN FUND BALANCES	(6,863,109)	(346,598)	(7,209,707)
FUND BALANCES — Beginning of year	43,063,277	110,896,419	153,959,696
FUND BALANCES — End of year	$ 36,200,168	$ 110,549,821	$ 146,749,989

See notes to basic financial statements.

THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES – GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES FOR THE YEAR ENDED JUNE 30, 2013

NET CHANGE IN FUND BALANCE - GOVERNMENTAL FUNDS	$	(7,209,707)
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES ARE DIFFERENT IN THE STATEMENT OF ACTIVITIES BECAUSE:		
Net change in receivable from Global Settlement Agreement is reported as revenue in the statement of activities, but is not reported in the fund financial statement since it does not provide current financial resources.		1,726,146
Net change in interest payable reported in the statement of activities that does not require the use of current financial resources, and therefore, are not reported as an expenditure in the governmental funds.		364,540
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces bonds payable in the statement of net position; this is the amount of redemption on bond principal during the year.		57,935,000
Interest capitalization on the 2005 and 2008 Series of the Tobacco Settlement Asset-Backed Bonds do not require the use of current financial resources, and therefore, are not reported as expenditure in governmental funds.		(33,397,878)
The amortization of deferred bond issue costs, loss on bonds refunded, and the accretion of bonds discount do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds:		
Amortization of bond issue costs		(802,029)
Accretion of bond discount		(1,437,700)
Amortization of loss on refunding		(2,964,000)
CHANGE IN NET DEFICIT OF GOVERNMENTAL ACTIVITIES	$	14,214,372

See notes to basic financial statements.

1. REPORTING ENTITY

The Children's Trust (the "Trust") is a component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created by Act 173 of the Legislature of the Commonwealth on July 30, 1999, as amended, (the "Act 173"), and an affiliate of the Government Development Bank for Puerto Rico (the "Bank"), a component unit of the Commonwealth. The Trust was created for the purpose of developing programs aimed at promoting a better quality of life and the well-being of families, children, and youth in Puerto Rico, especially in the areas of education, recreation and health. These programs were financed with the moneys to be received by the Commonwealth from the Global Settlement Agreement dated November 23, 1998 (the "Agreement") between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. Pursuant to the Act 173, the Commonwealth assigned and transferred to the Trust the contributions which the Commonwealth is entitled to receive under the Agreement. The Agreement calls for annual payments through the year 2025, which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity. Currently, all of the proceeds received from the Agreement are pledged for debt service.

The Act 173 provides that the Bank will act as the trustee of the Trust. Pursuant to the Act 173, the Trust is exempt from taxation in Puerto Rico.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Trust conform to Accounting Principles Generally Accepted in the United States of America ("GAAP"), for governments as prescribed by the Governmental Accounting Standards Board ("GASB").

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

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

Government-Wide and Fund Financial Statements

Government-Wide Financial Statements — The statement of net deficit and the statement of activities report information on all activities of the Trust. The effect of interfund balances has been removed from both statements. Governmental activities are financed through revenue from the Agreement, intergovernmental revenue, and investment earnings.

The statement of net deficit presents the Trust's assets and liabilities, with the difference reported as net deficit.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include earnings on investments. Other items not meeting the definition of program revenues are reported as general revenues.

Fund's 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. All of the financial activities of the Trust are reported in the accompanying basic financial statements and have been classified as governmental. All funds of the Trust are major funds.

Fund balances for each governmental fund are displayed in the following classifications depicting the relative strength of the spending constraints placed on the purposes for which resources can be used:

- Nonspendable — amounts that cannot be spent because they are either not in a spendable form (such as inventories and prepaid amounts) or are legally or contractually required to be maintained intact.
- Restricted — amounts that can be spent only for specific purposes because of constraints imposed by external providers (such as grantors, bondholders, and higher levels of government), or imposed by constitutional provisions or enabling legislation.
- Committed — amounts that can be spent only for specific purposes determined by a formal action of the government's highest level of decision-making authority.
- Assigned — amounts the government intends to use for specific purposes that do not meet the criteria to be classified as restricted or committed.
- Unassigned — amounts that are available for any purpose.

When both restricted and unrestricted resources are available for use, it is the Trust's policy to use restricted resources first, and then, unrestricted resources as they are needed.

Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

Governmental Fund's Financial Statements — The governmental fund's financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized when they become measurable and available. Revenue is considered to be available when it is collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the Trust considers revenues to be available if they are to be collected within 120 days after the end of the current fiscal year-end. Expenditures are recorded when the related liability is incurred. An exception to this general rule includes principal and interest on general long-term debt, which is recognized when due.

The financial activities of the Trust that are reported in the accompanying basic financial statements have been classified into the following major governmental funds:

- *General Fund* — The general fund is used to account for grants awarded to promote a better quality of life and the well-being of families, children, and youth in Puerto Rico. During the year ended June 30, 2013, grants were awarded for education, health, and recreational activities.

- *Debt Service Fund* — This debt service fund is used to account for proceeds from the Agreement and for the payment of interest and principal on long-term obligations.

Budgetary Accounting — The Trust is not required by the Act 173 to submit a budget for approval by the Legislature of the Commonwealth; consequently, no formal budgetary accounting procedures are followed.

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

Cash Equivalents — Cash equivalents are defined as highly liquid investments with original maturities at the date of purchase of three months or less.

Investments and Investment Contracts — Investments and investment contracts are carried at fair value, except for money market investments and participating investment contracts with a remaining maturity at the time of purchase of one year or less, and non-participating investment contracts, carried at cost, which approximate fair value. Fair value is determined based on quoted market prices, and quotations received from independent broker/dealers or pricing services organizations.

Bond Issue Costs and Bond Discounts — Bond issue costs and bond discounts are amortized and accreted, respectively, over the life of the debt using the effective interest method in the government-wide financial statements. Issuance cost of bonds and bond discounts accounted for in the governmental funds are recorded as expenditures when paid.

Refunding — Refunding involve the issuance of new debt whose proceeds are used to repay immediately (current refunding) or at a future time (advance refunding) previously issued debt. The difference between the reacquisition price and the net carrying amount of the old debt is deferred and amortized as a component of interest expense in the statement of activities, over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount is reported on the statement of net deficit as an addition to or deduction from the new debt.

Deferred Revenue — Deferred revenue at the governmental fund level arises when potential revenue does not meet the "available" criteria for revenue recognition in the current period. Deferred revenue also arises when resources are received before the Trust has a legal claim to them, as when grant moneys are received prior to incurring the qualifying expenditures. In subsequent periods, when the revenue recognition criteria is met, or when the Trust has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet, and the revenue is recognized. Deferred revenue at the government wide level arises only when the Trust receives resources before it has a legal claim to them.

Tobacco Settlement — The Trust follows the GASB Technical Bulletin No. 2004-1, *Tobacco Settlement Recognition and Financial Reporting Entity Issue*, as amended by GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues* (the "GASB 48"), which provides accounting guidance for entities created to obtain the rights to all or a portion of future tobacco settlement resources and for the governments that create such entities.

GASB 48 indicates that the entity created to obtain the rights, which is called the Tobacco Settlement Authority ("TSA"), should be considered a component unit of the government that created it and that the component unit should be accounted for as blended component unit. GASB 48 also states that the government receiving the payments from the tobacco companies under the Agreement, which is called the settling government, should recognize a receivable and revenue for tobacco settlement resources when an event occurs. The event that results in the recognition of an asset and revenue by a settling government is the domestic shipment of cigarettes. GASB 48 indicates that accruals should be made by the settling government and TSA for estimated shipments from January 1 to their respective fiscal year-ends, since the annual payments are based on a calendar year. However, under the modified-accrual basis of accounting at the fund level, revenue should be recognized only to the extent that resources are available.

GASB 48 addresses the question of how the settling governments should report the receipt of the resources provided by the TSA's remittances of the proceeds of the bonds sold. Since the TSA should be reported as a blended component unit, GASB 48 indicates these remittances should be reported as transfers into the fund receiving the proceeds and transfers out in the fund that accounts for the activities of the TSA. Since the Trust has no contractual obligation, under its enabling legislation or elsewhere, to remit all bond proceeds or assets related to the Agreement to the settling government (the Commonwealth), the Trust recognizes as expenses amounts that are disbursed for grants to its settling government (including its instrumentalities) or third parties.

GASB has issued the following accounting pronouncements that have effective date after June 30, 2013:

(a) GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities,* which is effective for fiscal years beginning after December 15, 2012.

(b) GASB Statement No. 66, *Technical Corrections-2012* - an *amendment of GASB Statements No. 10 and No. 62,* which is effective for fiscal years beginning after December 15, 2012.

(c) GASB Statement No. 67, *Financial Reporting for Pension Plans – and amendment of GASB Statement No. 25,* which is effective for fiscal years beginning after June 15, 2013.

(d) GASB Statement No. 68, Accounting *and Financial Reporting for Pensions – an amendment of GASB Statements No. 27,* which is effective for fiscal years beginning after June 15, 2014.

(e) GASB Statement No. 69, *Government Combinations and Disposals of Government Operations,* which is effective for periods beginning after December 15, 2013.

(f) GASB Statement No. 70, A*ccounting and Financial Reporting for Non Exchange Financial Guarantees,* which is effective for periods beginning after June 15, 2013.

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

3. CUSTODIAL CREDIT RISK

Custodial credit risk is the risk that in the event of a bank failure, the Trust's deposits may not be returned. The Trust does not have a deposit policy for custodial credit risk. As of June 30, 2013, all of the Trust's depository bank balance, aggregating approximately $19,534,000, was exposed to custodial credit risk since such deposits, all of which are maintained at the Bank, are uninsured and uncollateralized.

4. SERVICE AGREEMENT

The Trust has an agreement with the Bank whereby the Bank provides managerial, administrative and financial services to the Trust. Pursuant to this agreement, the Trust was charged $200,000 for various expenses in fiscal years 2013 and the amount was included in accounts payable as of June 30, 2013.

5. INVESTMENTS AND INVESTMENT CONTRACTS

The Trust follows the investment guidelines promulgated by the Bank under the authority provided by Act No. 113 of August 3, 1995 and Executive Order 1995-50A which detail which investments categories may be purchased or entered by the Trust. The Bank's investment policies establish limitations and other guidelines on maturities and amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country.

Therefore, the Bank's investment policies allow management to purchase or enter into the following investment instruments:

- U.S. government and agencies obligations
- Certificates of deposit and time deposits
- Bankers' acceptances
- Obligations of the Commonwealth of Puerto Rico, its agencies, municipalities, public corporations, and instrumentalities
- Federal funds sold
- Securities purchased under agreements to resell
- World Bank securities
- Mortgage-backed and asset-backed securities
- Corporate debt, including investment contracts
- External investment pools
- Stock of corporations created under the laws of the United States of America or the Commonwealth of Puerto Rico
- Options, futures, and interest-rate swap agreements for hedging and risk control purposes, as well as for the creation of synthetic products which qualify under any of the foregoing investment categories
- Open-end mutual funds with acceptable underlying assets and rated AAA by Standard & Poor's or its equivalent by Moody's Investors Service.

The Trust's investment policies provide that the Bank's Asset Liability Management Committee ("ALCO") is responsible for implementing and monitoring the interest rate risk policies and strategies. The ALCO meets on a monthly basis to coordinate and monitor the interest rate risk management of interest sensitive assets and interest sensitive liabilities, including matching of their anticipated level and maturities, consistent with the Trust's liquidity, capital adequacy, risk, and profitability goals set by the Trust's board of directors.

As of June 30, 2013, the Trust maintains approximately $110.1 million in investments and investments contracts which are held as debt service reserves in trusted accounts that are governed by the applicable bond indenture. All of the funds used for debt services are held by the trustee in the name of the Trust with the exception of $83.7 million of nonparticipating investments contracts.

The following table summarizes the type and maturities of investments at fair value held by the Trust at June 30, 2013. Based on concentration credit risk, investments by type in any one issuer representing 5% or more of total investments have been separately disclosed.

Investment Type	Within One Year	After One to Five Years	After Five to Ten Years	After Ten Years	Total
Internal Investment pools - fixed income securities:					
PRGITF	$ 17,628,996	$ -	$ -	$ -	$ 17,628,996
External Investment pools - fixed income securities:					
Deutsche Bank - Guarantee investment contract	-	-	-	26,413,073	26,413,073
Nonparticipating investment contracts - Bayerishe Hypo-und Vereinsbank AG	-	-	-	83,684,234	83,684,234
	$ 17,628,996	$ -	$ -	$ 110,097,307	$ 127,726,303

Reconciliation to the government-wide statement of net position:	
Unrestricted investments and investment contracts	$ 17,628,996
Restricted investments and investment contracts	110,097,307
Total	$ 127,726,303

As of June 30, 2013, the rating of Puerto Rico Government Investment Trust Fund was AAA by Standard & Poor's. The rating of Deutsche Bank Trust Company Americas was A+/Neg/A-1 by Standard & Poor's and, the rating of Bayerische Hypo-und Vereinsbank AG was A/Stable/A-1 by Standard & Poor's.

6. BONDS PAYABLE

On October 10, 2002, the Trust refunded its then outstanding $390,170,000 Tobacco Settlement Asset Backed Bonds, Series 2000 dated as of October 1, 2000, with new 2002 Series bonds (the "Series 2002 Bonds") in the amount of $1,171,200,000.

As of June 30, 2013, the outstanding balance of these bonds consist of $17,265,000 serial bonds maturing on May 15, 2014, bearing an interest rate of 4.25%, and single rated term bonds (the "Term Bonds") maturing from May 15, 2023 to 2033 ($300,345,000 at 5.375%), from May 15, 2034 to 2039 ($310,380,000 at 5.5%) and from May 15, 2040 to 2043 ($296,255,000 at 5.625%).

The Term Bonds are subject to mandatory redemption in whole or in part prior to their respective stated maturity dates from the Agreement collections in excess of the minimum amount required to pay the scheduled annual debt service and administrative expenses may been used to redeem bonds at the redemption price of 100% of the principal amount thereof together with interest accrued thereon to the date fixed for redemption.

On June 30, 2005, the Trust issued a new series of Tobacco Settlement Asset-Backed Bonds, Series 2005A and 2005B (the "Series 2005A and 2005B Bonds"), for $108,209,446. The Series 2005A and 2005B consist of capital appreciation bonds maturing on May 15, 2050 ($74,523,430 at 6.50%), plus accreted interest and capital appreciation bonds maturing on May 15, 2055 ($33,686,016 at 7.25%), plus accreted interest, respectively. As of June 30, 2013, the outstanding balances of Series 2005A and 2005B consist of $124,329,924 and $59,557,200, respectively.

On April 30, 2008, the Trust issued a new series of Tobacco Settlement Asset-Backed Bonds, Series 2008A and 2008B (the "Series 2008A and 2008B Bonds"), for $195,878,970. The Series 2008A and 2008B consist of capital appreciation bonds maturing on May 15, 2057 ($139,003,082 at 7.625%), plus accreted interest and capital appreciation bonds maturing on May 15, 2057 ($56,875,888 at 8.375%), plus accreted interest, respectively. As of June 30, 2013, the outstanding balances of Series 2008A and 2008B consist of $204,604,021 and $86,895,484 respectively.

The Series 2008A and 2008B Bonds are subordinated and are not entitled to receive any payments until the date when the Series 2005A and 2005B Bonds are no longer outstanding. The Series 2005A and 2005B Bonds are subordinated and are not entitled to receive any payments until the date when the Series 2002 Bonds are no longer outstanding.

In addition, the Series 2008B and 2005B Bonds are subordinated to the Series 2008A and 2005A Bonds, respectively, and are not entitled to receive any payments until the date when the Series 2008A or 2005A Bonds are no longer outstanding. All bonds are secured by 100% of the annual payments received under the Agreement.

Changes in bonds payable for the year ended June 30, 2013, are summarized as follow (in thousands):

	Balance at July 1, 2012	Additions	Debt Paid	Other Increases	Balance at June 30, 2013	Due Within One Year
Bonds payable	$ 1,424,169	$ -	$ (57,935)	$ 33,398	$ 1,399,632	$ 17,265
Less:						
Unaccreted discount	(23,407)	-	-	1,437	(21,970)	-
Deferred loss on refunding	(30,455)	-	-	2,964	(27,491)	-
Bonds payable	$ 1,370,307	$ -	$ (57,935)	$ 37,799	$ 1,350,171	$ 17,265

As of June 30, 2013, debt service requirements for bonds outstanding were as follow (in thousands):

Year Ending June 30,	Principal	Interest	Total
2014	$ 17,265	$ 50,613	$ 67,878
2015	-	49,879	49,879
2016	-	49,879	49,879
2017	-	49,879	49,879
2018	-	49,879	49,879
2019–2023	3,540	249,394	252,934
2024–2028	552,867	236,051	788,918
2029–2033	170,960	197,439	368,399
2034–2038	248,500	143,411	391,911
2039–2043	358,135	63,132	421,267
2044–2048	-	-	-
2049–2053	-	-	-
2054–2057	8,634,580	-	8,634,580
	9,985,847	$ 1,139,556	$ 11,125,403
Less:			
Unaccreted discount	(21,970)		
Unamortized deferred loss on refunding	(27,491)		
Unaccreted interest	(8,586,215)		
Total Bonds payable	$ 1,350,171		

7. COMMITMENTS

At June 30, 2013, the Trust had approved commitments to provide assistance to several entities through thirty-six contracts with balances amounting to approximately $24,033,000 for educational, health, and recreational activities.

8. GLOBAL SETTLEMENT AGREEMENT

On November 23, 1998, the Agreement was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The Agreement calls for annual payments through the year 2025 which will vary due to inflationary and volume adjustments. After 2025, the tobacco companies shall continue making contributions in perpetuity.

Following is a summary of estimated collections to be received by the Trust through the year ending June 30, 2025 (unaudited, in thousands):

Year Ending June 30,		Amount
2014	$	81,698
2015		82,562
2016		83,588
2017		84,617
2018		95,824
2019-2025		703,225
Amount to be collected through the year ending June 30, 2025	$	1,131,514

Actual collections from the Agreement will fluctuate due to future cigarette consumption, which could be affected by factors such as inflation, demographics, cigarette prices, disposable income, employment, advertising expenditures, and regulations, among others. During 2013, actual collections were $107,687,982, or 33.3% more than the projected amount in the official statement for the year 2013.

All of the revenue received under the Agreement and investment earnings on certain accounts under the bond indentures are pledged as collateral for all bond issuances. Accordingly, until May 15, 2057, such revenues are not available for other purposes.

Amounts received under the bond issuances were used to finance programs aimed at promoting a better quality of life and the well-being of families, children, and youth in Puerto Rico especially in the areas of education, recreation, and health in form of grants. In addition, part of the proceeds from the Series 2008A and 2008B Bonds were used to pay certain operating expenses of the Commonwealth.

During the year ended June 30, 2013, pledged revenues amounted to $107,687,982, which were used to pay for $111,418,317 of related principal and interest of the bond issuances.

9. INTERGOVERNMENTAL GRANTS

The Trust has established intergovernmental agreements in order to disburse funds assigned by the Board of Directors of the Trust.

The detail of intergovernmental grants incurred during the year ended on June 30, 2013, is as follows (in thousands):

Description	Amount
Public Buildings Authority	$ 1,976
Office for the Improvement of Public Shools	726
	$ 2,702

Below is a summary of each intergovernmental agreement that provide a basis and legal context for disbursing the funds. The Trust has reserved it rights to amend any of the intergovernmental agreements in consultation with the corresponding governmental entities in order to take into consideration changes in the specific projects or redirecting the funds to other projects:

Public Building Authority

On December 27, 2005, the Trust signed an agreement with the Department of Education ("DE") for the assignment of $10 million, to perform structural improvements on six (6) schools for the amount of $6.3 million and the construction of ramps and improvements to the wastewater disposal system for $3.7 million.

On October 6, 2008, the DE signed an agreement with the Puerto Rico Infrastructure Financing Authority ("PRIFA") in which DE agreed to transfer $3.7 million to PRIFA for the construction of ramps and improvements to the wastewater disposal system in schools. As of June 30, 2013, the Trust has disbursed $2.6 million from the assigned funds. All projects were completed. The remaining $1.1 million is available to be used in other projects of the DE.

On March 10, 2006, the DE signed an agreement with Public Building Authority ("PBA") in which the DE agreed to transfers $6.3 million to the PBA to perform structural improvements on six (6) schools. As of June 30, 2013, a total of $6.2 million were disbursed, therefore, $100 thousand are available for the completion of those projects.

Office of the Improvement of Public Schools

Effective on November 5, 2002, the Trust entered into an agreement with the Office for the Improvements of Public Schools ("OMEP", by its Spanish acronym) for the assignment of $29 million. From this amount, $8 million were assigned for the construction and structural improvements of schools located in designated special communities, $5.2 million for schools requiring immediate improvements under the project One Thousand, $3 million for rehabilitation of schools to comply with the code of seismic resistant, $6.5 million for the project of vocational schools, $4 million for schools under a special project called School Renovation, and $2.8 million for the purchase of trucks to support brigades employed in activities related with the improvements and routine maintenance of public schools. As of June 30, 2013 a total of $28.1 million were disbursed, therefore, $900 thousand are available for the completion of those projects.

10. SUBSEQUENT EVENTS

Subsequent events were evaluated through December 10, 2013, the date the basic financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the June 30, 2013 financial statements.

THE CHILDREN'S TRUST
(A Component Unit of the Commonwealth of Puerto Rico)

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