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FIDEICOMISO DE LOS NIÑOS

Informe Anual para el Año Fiscal 2013- 2014
a la Asamblea Legislativa
y al Contralor de Puerto Rico

Fideicomiso de los Niños

Informe a la Asamblea Legislativa y al Contralor de Puerto Rico, Según Requerido por la Ley Núm. 173 del 30 de julio de 1999, Según Enmendada Año Fiscal 2014

Introducción

El Artículo 18 de la Ley Núm. 173 del 30 de julio de 1999, según enmendada, requiere que luego del 31 de marzo de cada año, el Fideicomiso de los Niños rinda un informe a la Asamblea Legislativa y al Contralor de Puerto Rico relacionado con el año fiscal anterior. Dicho informe deberá incluir:

1. Un estado financiero auditado por una compañía reconocida e informe completo de las actividades del Fideicomiso para el año fiscal anterior;

2. Una relación completa y detallada de todos los contratos y transacciones durante el año fiscal a que corresponda el informe;

3. Información sobre la situación y progreso de los financiamientos y actividades hasta la fecha del último informe.

Se rinde éste, el trigésimo informe del Fideicomiso de los Niños a la Asamblea Legislativa y al Contralor de Puerto Rico, de acuerdo con los términos de Ley.

Fideicomiso de los Niños

Año Fiscal 2014

I. Estado Financiero Auditado

Se incluyen, como Anejo I, los estados financieros auditados por la firma RSM ROC & Company para el año fiscal terminado el 30 de junio de 2014.

II. Informe de Actividades

Entidad Líder	Fecha Firma Contrato o Transacciones	Cantidad Aprobada
Año Fiscal 2014		
Departamento de Estado – Actividad Día de Reyes 2014	3-ene-2014	$925,000
Departamento de la Familia – Consejo de la Niñez	30-may-2014	$150,000

III. Situación de Progreso de los Financiamientos y Actividades del Año Fiscal 2014

El Fideicomiso desembolsó $2,760,148.97 por concepto de Servicios de Ayuda durante el año fiscal que terminó el 30 de junio de 2014. A continuación un detalle de los desembolsos para el año fiscal:

Entidad Líder	Cantidad Aprobada	Total Desembolsado 2013-2014
Casa de Niños Manuel Fernández Juncos	$660,450	$256,544
Fundación de Desarrollo Comunal de PR, Inc.	700,953	89,880
Instituto Especial Desarrollo Integral (Yauco)	354,368	1,648
Instituto Especial para el Desarrollo, IDIIFCO	641,200	11,448
Niños Escuchas de América	7,477,000	1,221,098
San Agustín del Coquí	3,294,660	228,165
Departamento de Educación (OMEP)	29,000,000	140,314
Departamento de Educación	10,000,000	15,659
Departamento de Estado (Tres Reyes 2009)	925,000	8,823
Departamento de Estado (Tres Reyes 2010)	925,000	66,730
Departamento de Estado (Tres Reyes 2014)	925,000	719,842
		$2,760,149

El total acumulado de desembolsos por año fiscal se detalla de la siguiente manera:

- Año Fiscal 2001 - $ 75,211,960.35
- Año Fiscal 2002 - $171,690,102.13
- Año Fiscal 2003 - $483,762,894.97
- Año Fiscal 2004 - $149,142,073.47
- Año Fiscal 2005 - $182,975,610.14
- Año Fiscal 2006 - $ 44,250,818.76
- Año Fiscal 2007 - $ 96,800,748.97
- Año Fiscal 2008 - $112,855,926.94
- Año Fiscal 2009 - $ 11,236,966.30
- Año Fiscal 2010 - $ 5,851,868.88
- Año Fiscal 2011 - $ 8,443,371.59
- Año Fiscal 2012 - $ 3,944,976.19
- Año Fiscal 2013 - $ 6,366,296.85
- Año Fiscal 2014 - $ 2,760,148.97

Anejo I

Fideicomiso de los Niños

Estados Auditados al 30 de junio de 2014

RSM ROC & Company
Certified Public Accountants & Consultants

The Children's Trust
(A Component Unit of the Commonwealth of Puerto Rico)

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

FIDEICOMISO de los niños

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

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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 governmental activities, each major fund, and the aggregate remaining fund information of The Children's Trust, a Component Unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2014, 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.

RSM ROC & Company is a member of the RSM network. Each member of the RSM network is an independent accounting and advisory firm which practices in its own right. The RSM network is not itself a separate legal entity in any jurisdiction.

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, 2014, 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.

Emphasis of Matter

As discussed in Note 2 to the financial statements, effective July 1, 2013, The Children's Trust adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 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, 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
October 15, 2014

Stamp No. E138075 was affixed to
the original of this report.

RSM ROC & Company
Certified Public Accountants & Consultants

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, 2014. Please read it in conjunction with the Trust's basic financial statements including the notes thereto, which follow this section.

1. FINANCIAL HIGHLIGHTS

- During 2014, the Trust implemented the Governmental Accounting Standard Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities.* As a result of the implementation of Statement No. 65, the deferred bond issue cost was recognized as an expense in the beginning balance of the unrestricted net deficit, the deferred loss from refunding is presented as a deferred outflows of resources and not as part of bonds payable, net, and the deferred revenue is presented as a deferred inflows of resources and not as a liability. The financial information included in the Management's Discussion & Analysis (MD&A) was adjusted to reflect the impact of the implementation of Statement No. 65.

- The Trust's government-wide net deficiency increased by approximately $18 million to approximately $1,186 million as of June 30, 2014, or approximately 1.6%, from approximately $1,167 million as of June 30, 2013, as restated.

- Government-wide revenues from the Global Settlement Agreement for the fiscal year 2014 amounted to approximately $72 million, a decrease of approximately $37.4 million, or approximately 34.2%, from fiscal year 2013 of approximately $109.4 million.

- The Trust's operating expenses consist of payments for programs and activities permitted by the enabling legislation. Funds granted during 2014 accounted in the government-wide financials totaled approximately $2.6 million, a decrease of approximately $4.3 million, or approximately 61.8%, from approximately $6.9 million granted during 2013.

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 deferred outflows of resources and the liabilities and deferred inflows of resources, 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, deferred outflows of resources, liabilities, deferred inflows of resources, 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 whether 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 the deferred outflows of resources, and liabilities and the deferred inflows of resources — 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):

	As of June 30,		Change	
	2014	2013 (as restated)	Amount	Percent
Assets:				
Current assets	$ 33,791	$ 37,232	$ (3,441)	(9.2%)
Non-current restricted assets	151,270	152,860	(1,590)	(1.0%)
Total assets	185,061	190,092	(5,031)	(2.6%)
Deferred outflows of resources	24,527	27,491	(2,964)	(10.8%)
Liabilities:				
Current liabilities	6,753	24,623	(17,870)	(72.6%)
Non-current liability	1,388,428	1,360,397	28,031	2.1%
Total liabilities	1,395,181	1,385,020	10,161	0.7%
Net deficit	$ (1,185,593)	$ (1,167,437)	$ (18,156)	1.6%

As noted, the Trust's net deficit increased by approximately $18 million, from a deficit of approximately $1,167 million in 2013, as restated, to a deficit of approximately $1,186 million in 2014. This decrease results from the net effect of the decrease in total assets of approximately $5 million, which were used to pay grants and debt, and a decrease in deferred outflows of resources of approximately $2.9 million, mainly from the amortization of deferred loss on bonds refunding, and a net increase of approximately $10.1 million in total liabilities, mainly due to the net effect of interest capitalization for fiscal year 2014 of approximately $35.9 million, and the payment of principal on bonds of approximately $26.5 million.

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

Function/Program	For the Year Ended June 30, 2014	2013 (as restated)	Change Amount	Change Percent
Expenses of governmental activities:				
Education	$ 10	$ 156	$ (146)	(93.6%)
Health	303	424	(121)	(28.5%)
Recreation	2,179	3,629	(1,450)	(40.0%)
Intergovernmental grants	147	2,703	(2,556)	(94.6%)
Interest on long term debt and other - net	87,552	87,835	(283)	(0.3%)
Total	90,191	94,747	(4,556)	(4.8%)
Revenues of governmental activities:				
Investment earnings	23	35	(12)	(34.3%)
Global Settlement Agreement	72,012	109,415	(37,403)	(34.2%)
Other income	-	313	(313)	(100.0%)
Total	72,035	109,763	(37,728)	(34.4%)
Change in net deficit	$ (18,156)	$ 15,016	$ (33,172)	(220.9%)

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. The increase in net deficit of approximately $33 million is mainly related to: 1) a decrease on expenses related to governmental activities of approximately $4.6 million, and 2) a decrease on revenues of approximately $37.7 million.

The net decrease of approximately $4.6 million on governmental activities was mainly due to the fact that major recreation projects were completed during year 2013. In addition, requests for intergovernmental grants decreased during fiscal year 2014.

The decrease on total revenues of approximately $37.7 million was mainly due to the decrease of the operating contributions of approximately $37.4 million as a result of a decrease on the revenues received from the Global Settlement Agreement.

6. GOVERNMENTAL FUND FINANCIAL ANALYSIS

The Trust's governmental funds reported fund balances of approximately $142.3 million as of June 30, 2014, which is approximately $4.4 million less than prior year. The decrease in fund balance in the governmental funds is mainly due to grants disbursements of approximately $2.6 million during fiscal year 2014, and $1.5 million paid from the Trust resources to complete the debt service payment, since total revenues of approximately $75.5 was insufficient to cover the principal and interest payment of approximately $77 million.

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

	As of June 30,		Change	
	2014	2013	Amount	Percent
Assets	$ 185,061	$ 190,092	$ (5,031)	(2.6%)
Liabilities and deferred inflows of resources	$ 42,764	$ 43,342	$ (578)	(1.3%)
Fund balances	142,297	146,750	(4,453)	(3.0%)
Total liabilities, deferred inflows of resources and fund balances	$ 185,061	$ 190,092	$ (5,031)	(2.6%)

7. DEBT ADMINISTRATION

During the year ended June 30, 2014, principal payments on bonds payable amounted to approximately $26.5 million. As of June 30, 2014, remaining balance on bonds was approximately $1,388 million, net of approximately $20.7 million of non-accreted bond discount, 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, 2014

	Governmental Activities
ASSETS	
CURRENT ASSETS:	
Interest-bearing deposits with Government Development Bank for Puerto Rico	$ 18,383,023
Investments and investment contracts	15,406,358
Accrued interest receivable	1,504
Total current assets	33,790,885
CERTIFICATE OF DEPOSIT	66,826
NONCURRENT RESTRICTED ASSETS:	
Investments and investment contracts	108,568,080
Accrued interest receivable	441,785
Receivable from Global Settlement Agreement	42,192,983
Total noncurrent restricted assets	151,202,848
Total assets	185,060,559
DEFERRED OUTFLOWS OF RESOURCES —	
Deferred loss on bonds defeasance	24,527,105
LIABILITIES	
CURRENT LIABILITIES:	
Accounts payable	570,873
Liabilities payable from restricted assets- Accrued interest payable	6,182,424
Total current liabilities	6,753,297
NONCURRENT LIABILITY — Bonds payable - due in more than one year	1,388,427,978
Total liabilities	1,395,181,275
NET DEFICIT	
Restricted	145,020,424
Unrestricted	(1,330,614,035)
Total net deficit	$ (1,185,593,611)

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, 2014

Functions/Programs	Expenses	Program Revenues: Investment Earnings	Program Revenues: Operating Contributions	Net Revenues/(Expenses) and Changes in Net Deficit
GOVERNMENTAL ACTIVITIES:				
Education	$ 10,413	$ -	$ -	$ (10,413)
Health	302,606	-	-	(302,606)
Recreation	2,179,417	-	-	(2,179,417)
Intergovernmental grants	147,214	-	-	(147,214)
Debt service and other	90,935,818	3,383,651	72,012,174	(15,539,993)
Total governmental activities	$ 93,575,468	$ 3,383,651	$ 72,012,174	(18,179,643)
GENERAL REVENUES — Investment earnings				23,416
CHANGE IN NET DEFICIT				(18,156,227)
NET DEFICIT — Beginning of year, as previously reported				(1,160,747,241)
Restatement of beginning net deficit (note 6)				(6,690,143)
NET DEFICIT — Beginning of year, as restated				(1,167,437,384)
NET DEFICIT — End of year				$ (1,185,593,611)

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, 2014

	General Fund	Debt Service Fund	Total Governmental Funds
ASSETS			
Interest-bearing deposits with Government Development Bank for Puerto Rico	$ 18,383,023	$ -	$ 18,383,023
Certificate of deposit	66,826	-	66,826
Investments and investment contracts	15,406,358	108,568,080	123,974,438
Accrued interest receivable	1,504	441,785	443,289
Receivable from Global Settlement Agreement	-	42,192,983	42,192,983
Total assets	$ 33,857,711	$ 151,202,848	$ 185,060,559
LIABILITIES, DEFERRED INFLOWS OF RESOURCES AND FUND BALANCES			
LIABILITIES — accounts payable	$ 570,873	$ -	$ 570,873
DEFERRED INFLOWS OF RESOURCES — Deferred revenue	-	42,192,983	42,192,983
FUND BALANCES:			
Restricted	-	109,009,865	109,009,865
Committed	26,420,578	-	26,420,578
Assigned	2,850,708	-	2,850,708
Unassigned	4,015,552	-	4,015,552
Total fund balances	33,286,838	109,009,865	142,296,703
Total liabilities, deferred inflows of resources and fund balances	$ 33,857,711	$ 151,202,848	$ 185,060,559

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, 2014

FUND BALANCES OF GOVERNMENTAL FUNDS	$	142,296,703
AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES ARE DIFFERENT IN THE STATEMENT OF NET DEFICIT BECAUSE:		
Receivable from Global Settlement Agreement to be applied to debt service will not be received in the current period and, therefore, is reported as deferred inflows of resources in the fund financial statements.		42,192,983
Accrued interest payable is not due and payable in the current period and, therefore, is not reported in the fund financial statements.		(6,182,424)
Bonds payable are not due and payable in the current period and, therefore, are not reported in the fund financial statements.		(1,409,086,426)
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.		20,658,448
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 presented as deferred outflows of resources in the statement of net deficit.		24,527,105
NET DEFICIT OF GOVERNMENTAL ACTIVITIES	$	(1,185,593,611)

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, 2014

	General Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Investment earnings	$ 23,416	$ 3,383,651	$ 3,407,067
Revenue from Global Settlement Agreement	-	72,129,865	72,129,865
Total revenues	23,416	75,513,516	75,536,932
EXPENDITURES:			
Education	10,413	-	10,413
Health	302,606	-	302,606
Recreation	2,179,417	-	2,179,417
Intergovernmental	147,214	-	147,214
Other	301,096	-	301,096
Debt service:			
Principal	-	26,480,000	26,480,000
Interest	-	50,569,472	50,569,472
Total expenditures	2,940,746	77,049,472	79,990,218
OTHER FINANCING SOURCES/(USES) — Transfers in/(out)	4,000	(4,000)	-
NET CHANGES IN FUND BALANCES	(2,913,330)	(1,539,956)	(4,453,286)
FUND BALANCES — Beginning of year	36,200,168	110,549,821	146,749,989
FUND BALANCES — End of year	$ 33,286,838	$ 109,009,865	$ 142,296,703

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, 2014

NET CHANGE IN FUND BALANCE - GOVERNMENTAL FUNDS	$ (4,453,286)
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.	(117,691)
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.	144,145
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.	26,480,000
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.	(35,934,795)
The amortization of deferred 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:	
Accretion of bond discount	(1,310,600)
Amortization of loss on refunding	(2,964,000)
CHANGE IN NET DEFICIT OF GOVERNMENTAL ACTIVITIES	$ (18,156,227)

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").

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities.* The Statement established accounting and reporting standards that reclassified certain items that were previously reported as assets and liabilities to deferred outflows of resources or deferred inflows of resources and that recognized certain items previously reported as assets and liabilities as outflows and inflows of resources. In addition, it limits the use of the term deferred in the financial statement presentation. The provisions of GASB Statement No. 65 are effective for financial statement for periods beginning after December 15, 2012. In fiscal year 2014, the Trust implemented GASB Statement No. 65, which required the Trust to retroactively recognize bond issuance costs as outflows of resources and restate its fiscal year 2013 financial statements by eliminating any carrying amounts of bond issuance costs and related amortization thereof, or when the restatement is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning net position. Refer to Note 6 of the financial statements for current year impact of this implementation.

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 revenues from the Agreement, intergovernmental revenues, and investment earnings.

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

Net position (deficit) is reported in three categories:

- Net investment in capital assets – consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any.
- Restricted – results when constraints placed on net position use are either externally imposed by creditors, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is The Trust's policy to use restricted resources first and the unrestricted resources when they are needed.
- Unrestricted – consists of net position that does not meet the definition of the two preceding categories. Unrestricted net position often is designated to indicate that management does not consider it to be available for general operations. Unrestricted net position often has constraints on resources, which are imposed by management, but can be removed or modified.

As of June 30, 2014, the Trust's net deficit is presented as restricted and unrestricted 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 revenues 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. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the 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, 2014, 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 — In the government-wide financial statements and the governmental funds financial statements, the bond issue costs are recorded as expenditures when paid. Discount on bonds is accreted over the life of the debt using the effective interest method in the government-wide financial statements. Discount on bonds is accounted for in the governmental funds 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 deferred outflows of resources.

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. The deferred amount is reported on the governmental funds balance sheet as deferred inflows of resources.

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, 2014:

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

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

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

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

(e) GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB No. 68*, which is effective simultaneously with the provisions of GASB Statement No. 68.

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, 2014, all of the Trust's depository bank balance, aggregating approximately $18,385,000, 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 year ended June 30, 2014 and the amount was included in accounts payable as of June 30, 2014.

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 service agreement with the Bank provides 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, 2014, the Trust maintains approximately $108.6 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, 2014. 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:					
Puerto Rico Government InvestmentTrust Fund	$ 15,406,358	$ -	$ -	$ -	$ 15,406,358
External Investment pools- fixed income securities:					
US Bank - Guarantee investment contract	-	-	-	24,883,846	24,883,846
Nonparticipating investment contracts-					
UniCredit Bank AG	-	-	-	83,684,234	83,684,234
	$ 15,406,358	$ -	$ -	$ 108,568,080	$ 123,974,438
Reconciliation to the government-wide statement of net deficit:					
Unrestricted investments and investment contracts					$ 15,406,358
Restricted investments and investment contracts					108,568,080
Total					$ 123,974,438

The credit quality ratings for investments and investments contracts as of June 30, 2014, are as follows:

Counter Party	Credit Risk Rating	
	Standard & Poor's	Moody's
Puerto Rico Government Investment Trust Fund	AAAm	Am
US Bank	AA-/Stable	Aa3/Stable
UniCredit Bank AG	BBB/Negative	Baa2/Negative

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, 2014, the outstanding balance of these bonds consist of single rated term bonds (the "Term Bonds") maturing from May 15, 2023 to 2033 ($291,130,000 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, 2014, the outstanding balances of Series 2005A and 2005B consist of $132,542,692 and $63,953,359, 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, 2014, the outstanding balances of Series 2008A and 2008B consist of $220,506,460 and $94,318,916 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.

As described in Note 2 of the financial statements, the Trust adopted GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities.* This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities, or viceversa. This Statement also requires the write-off of any existing deferred debt issuance costs at the time of adoption against beginning net position, and prospectively, any new debt issue costs on bonds or debt issuance will require immediate expensing.

At transition, the impact of GASB Statement No. 65 at the Trust was as follows:

Refunding of Bonds— The unamortized deferred loss on refunding bonds is now required to be presented as a deferred outflows of resources. The Trust reclassified the beginning unamortized deferred loss on refunding bonds of approximately $27.5 million, as a deferred outflows of resources, which had previously been reported as a deduction of debt.

Debt Issuance Costs— The Trust charged-off its existing unamortized debt issuance costs of approximately $6.7 million, against its beginning net deficit.

Changes in bonds payable for the year ended June 30, 2014, are summarized as follow (in thousands):

	Balance at July 1, 2013 (as restated)	Additions	Debt Paid	Other Increases	Balance at June 30, 2014	Due Within One Year
Bonds payable	$ 1,399,632	$ -	$ (26,480)	$ 35,935	$ 1,409,087	$ -
Less:						
Unaccreted discount	(21,970)	-	-	1,311	(20,659)	-
Bonds payable	$ 1,377,662	$ -	$ (26,480)	$ 37,246	$ 1,388,428	$ -

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Changes in deferred outflows of resources during the year ended June 30, 2014, are summarized as follow (in thousands):

	Balance at July 1, 2013	Accretion	Balance at June 30, 2014
Deferred loss on refunding	$ (27,491)	$ 2,964	$ (24,527)

As of June 30, 2014, debt service requirements for bonds outstanding were as follow (in thousands):

Year Ending June 30,	Principal	Interest	Total
2015	$ -	$ 49,421	$ 49,421
2016	-	49,384	49,384
2017	-	49,384	49,384
2018	-	49,384	49,384
2019	-	49,383	49,383
2020–2024	91,576	246,917	338,493
2025–2029	485,821	229,287	715,108
2030–2034	183,140	188,250	371,390
2035–2039	267,995	129,743	397,738
2040–2044	296,255	43,064	339,319
2045–2049	-	-	-
2050–2054	-	-	-
2055–2057	8,634,580	-	8,634,580
	9,959,367	$ 1,084,217	$ 11,043,584
Less:			
Unaccreted discount	(20,659)		
Unaccreted interest	(8,550,280)		
Total Bonds payable	$ 1,388,428		

7. COMMITMENTS

At June 30, 2014, the Trust had approved commitments to provide assistance to several entities through twenty-four contracts with balances amounting to approximately $16,294,000 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 projected collections amounts in the official statement that should be received by the Trust through the year ending June 30, 2025 (unaudited, in thousands):

Year Ending June 30,	Amount
2015	$ 82,562
2016	83,588
2017	84,617
2018	95,824
2019	96,937
2020-2025	606,288
Amount to be collected through the year ending June 30, 2025	$ 1,049,816

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 2014, actual collections were $72,129,865 or 12% less than the projected amount in the official statement for the year 2014.

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.

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, 2014, pledged revenues amounted to $72,129,865, which were used to pay for $77,049,472 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, 2014, is as follows (in thousands):

Description	Amount
Public Buildings Authority	$ 7
Office for the Improvement of Public Shools	140
	$ 147

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 Buildings Authority ("PBA")

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, 2014, 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 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, 2014, 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, 2014 a total of $28.6 million were disbursed, therefore, $419 thousand are available for the completion of those projects.

10. SUBSEQUENT EVENTS

Subsequent events were evaluated through October 15, 2014, 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, 2014 financial statements.