



**Commonwealth Plan of Adjustment
Pension Reserve Trust**

**Fund Financial Statements
Fiscal Year Ended June 30, 2024
(With Independent Auditors' Report)**

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Independent Auditors' Report

Board of Trustees
Puerto Rico Pension Reserve Trust

Opinion

We have audited the fund financial statements of the Puerto Rico Pension Reserve Trust (the Trust), as of and for the year ended June 30, 2024, and the related notes to the financial statements, which collectively comprise the Trust's basic financial statements as listed in the table of contents.

In our opinion, the accompanying financial statements referred to above present fairly, in all material respects, the respective financial position of Trust, as of June 30, 2024, and the respective changes in financial position and, where applicable, for the year then ended in accordance with U.S. generally accepted accounting principles.

Basis for Opinion

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Trust and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Emphasis of Matter

As discussed in Note 1, the financial statements of the Trust are intended to present the financial position and changes in financial position of only that portion of the general fund of the Commonwealth of Puerto Rico (the Commonwealth) that is attributable to the transactions of the Trust. They do not purport to, and do not, present fairly the financial position of the Commonwealth, as of June 30, 2024, and the changes in its financial position for the period then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with U.S. generally accepted accounting principles, and for 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.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Trust's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The



risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit 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 Trust's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Trust's ability to continue as a going concern for a reasonable period of time.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information is the responsibility of management and, 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 GAAS, 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.

KPMG LLP

San Juan, Puerto Rico
November 14, 2024

Stamp No. E584031 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.



Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2024

(Unaudited)

Overview

This section presents management’s discussion and analysis of the Commonwealth Plan of Adjustment Pension Reserve Trust’s (the “Pension Reserve Trust” or the “Trust”) financial performance for the fiscal year ended June 30, 2024 and should be read in conjunction with the financial statements, which follow this section.

The Pension Reserve Trust is a Puerto Rico irrevocable public trust duly organized due to the execution of that certain Deed of Public Trust (the “Deed of Trust”), effective as of March 14th, 2022, pursuant to the provisions of Chapter III of Act 219 of August 31st, 2012, as amended (the “Trust Act”) to provide financial support for the Government’s pension obligations under the pay-as-you-go pension system (the “PayGo System”) created pursuant to the provisions of Act 106 of August 23, 2017.

The Guidelines for the Governance and Administration of the Puerto Rico Plan of Adjustment Pension Reserve Trust and Monitoring of Plan of Adjustment Pension Benefits (the “Guidelines”) are incorporated into the Deed of Trust. The Trust is overseen by a five-person board of trustees (the “Pension Reserve Board” or the “Board”), which is tasked with providing independent and professional management of the Trust’s assets. As part of the Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico (the “Plan”), the Government of Puerto Rico (the “Government”) has agreed to provide contributions to the Trust on a yearly basis through the fiscal year ending June 30, 2031. These contributions will be received in the form of a base contribution, as well as an additional contribution contingent on the economic performance of the Government.¹

During fiscal year 2024, the Trust obtained a Private Letter Ruling from the Internal Revenue Service of the United States Department of the Treasury notifying that the Trust is not subject to taxes imposed by the United States Government. In addition, the Trust obtained a separate Private Letter Ruling from the Puerto Rico Treasury Department that states, among other things, the following:

- The assets of the Trust are autonomous and separate from the assets of the Government and are not considered part of the General Fund. Accordingly, the services rendered to the Trust or the Pension Reserve Board from outside of Puerto Rico are not subject to the exception rule of Section 1035.02(a)(3) of the Puerto Rico Internal Revenue Code, as applicable to the sourcing of income.
- The Trust and the Pension Reserve Board are not subject to the filing of an income tax return or informative return, as required by Subchapter A of Chapter 6 of Subtitle A of the Puerto Rico Internal Revenue Code.
- The Trust and the Pension Reserve Board are not subject to any tax imposed by the Government of Puerto Rico including the sales and use tax, for which a Certificate of Exemption and Total Waiver Certificate from Sales and Use Tax as an Agent of the Government have been obtained.

¹ It is worth noting that the Pension Reserve Board, the Pension Benefits Council, the Commonwealth of Puerto Rico and the Federal Management Oversight Board for Puerto Rico (“FOMB”), as sole Title III representative of the Commonwealth under the *Puerto Rico Oversight, Management, and Economic Stability Act* (“PROMESA”), as codified in 48 USC §§2101-2241, have unanimously agreed to amend and/or clarify certain provisions of the Deed of Trust and the Guidelines. Consequently, a *Motion of The Financial Oversight and Management Board For Puerto Rico For Order Pursuant To Bankruptcy Code Section 1142 In Aid Of Plan Implementation* to that respect has been filed by the FOMB on behalf of all relevant parties before the United States District Court for the District of Puerto Rico.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2024

(Unaudited)

Furthermore, starting in July 2023, the Trust began to implement its investment strategy as approved within the Pension Reserve Board’s Investment Policy Statement by purchasing investments using a dollar-cost averaging methodology.

The Financial Statements include the balance sheet and the statement of revenues, expenditures, and change in fund balance. They present the financial position of the Trust as of June 30, 2024, and its financial activities for the year then ended. The notes to the financial statements provide further information that is essential to a full understanding of the financial statements. The notes describe the significant accounting policies of the Pension Reserve Trust and provide detailed disclosures on certain account balances.

The financial statements of the Pension Reserve Trust are prepared in conformity with U.S. Generally Accepted Accounting Principles (“GAAP”) for governments as prescribed by the Governmental Accounting Standards Board (“GASB”) and reported using the current financial resources measurement focus and the modified accrual basis of accounting. Further, this complies with Article 5.7 of the Deed of Trust, which requires the Trust to “... keep accurate records and books of account of all transactions affecting assets of the Pension Reserve Trust, following standards that are generally accepted in public pension funds in the United States”.

Investment Strategy

As part of the investment objectives embedded in the Deed of Trust and the Guidelines, the objective of the Trust’s investment program is to generate returns within an appropriately risk-constrained framework, net of reasonable investment fees and expenses, that must serve the intended purposes of the Pension Reserve Trust under the Plan. The above will be achieved by means of a carefully planned and executed long-term investment program as developed and adopted by the Pension Reserve Board (the “Investment Policy Statement”) with expert assistance from its investment advisors. As of June 30, 2024, the investment advisors of the Trust were NEPC, LLC (“NEPC”).

On May 5, 2023, the Board adopted the Investment Policy Statement. The Pension Reserve Board adopted an investment strategy with the goal of generating enough monies to support pension obligations by investing contributions received from the Government in line with these objectives. The Investment Policy Statement is intended to assist the Pension Reserve Board in carrying out its fiduciary responsibilities for the prudent investment of the assets of the Trust and is designed to set forth the goals, objectives, and risk tolerances of the Pension Reserve Trust’s investment program. The Investment Policy Statement includes the mechanism to effectively supervise, monitor, and evaluate the investment of the assets of the Trust, all in furtherance of the investment objective defined in Section 8.1D of the Guidelines. The objectives of the Investment Policy Statement are based on currently available information, including but not limited to the Government’s Certified Fiscal Plan. If there is a material change in relevant forecasts and projections, the Board could reevaluate the investment strategy and objectives set forth in the Investment Policy Statement.

The Board’s asset allocation plan embodies its decisions to invest portions of the Trust in high-quality fixed income securities (US Treasury Bills, Bonds & Notes, discount notes, investment grade corporate bonds, etc.), equity securities, global fixed income securities, below investment grade corporate bonds, private credit, public market real assets, real estate, amongst others. As such, the Pension Reserve Board will implement an investment strategy with a flexible approach using target allocation ranges adopted in the Investment Policy Statement.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2024

(Unaudited)

All Annual Contributions received from the Government are deposited into the custodian bank account and invested in accordance with the Investment Policy Statement approved by the Pension Reserve Board. No material or relevant changes were experienced in the forecast and/or projections as considered in the Investment Policy Statement.

In the instances of additional government contributions, the Board may use a short-term dollar-cost averaging approach. During this period, the PRT will invest the cash proceeds in either the default cash option or an equivalent set of holdings (e.g., treasuries, discount notes, or other government securities).

Financial Highlights

- The fund balance of the Pension Reserve Trust increased \$1.3 billion during the year ended June 30, 2024. Total fund balance was \$2.74 billion at June 30, 2024, compared to \$1.47 billion at June 30, 2023.
- Total excess of revenues over expenditures for FY 2024 was \$187.5 million, compared to \$43.4 million for FY 2023.
- Transfers in from the Commonwealth to the Pension Reserve Trust totaled \$1.1 billion during the year ended June 30, 2024, compared to \$1.4 billion during the year ended June 30, 2023.
- Distributions to the Pension Benefits Council totaled \$2.3 million during the year ended June 30, 2024, compared to \$578 thousand during the period ended June 30, 2023.

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2024

(Unaudited)

Condensed Financial Information

Summary balances and activities of the Pension Reserve Trust as of and for the year ended June 30, 2024, and as of and for the year ended June 30, 2023, are presented below:

Summary of fund balance:

| | <u>June 30, 2024</u> (In thousands) | <u>June 30, 2023</u> (In thousands) |
|--|--|--|
| Assets: | | |
| Cash – operational | \$ 829 | 2,022 |
| Cash equivalent held in money market account | 90,218 | - |
| Investments at fair value | 2,654,001 | 1,466,491 |
| Operating lease right-of-use asset | 210 | 234 |
| Property, plant & equipment – net | 13 | 16 |
| Other assets | 84 | 63 |
| Total assets | <u>2,745,355</u> | <u>1,468,826</u> |
| Liabilities: | | |
| Accounts payable | 65 | 165 |
| Accrued expenses | 406 | 245 |
| Personnel related payable | 21 | 14 |
| Operating lease liability | 210 | 234 |
| Withholding taxes | 5 | 7 |
| Total liabilities | <u>707</u> | <u>665</u> |
| Fund balance – restricted | <u>\$ 2,744,648</u> | <u>1,468,161</u> |

Summary of revenues, expenditures, and change in fund balance:

| | <u>June 30, 2024</u> (In thousands) | <u>June 30, 2023</u> (In thousands) |
|---|--|--|
| Revenues: | | |
| Interest Income | \$ 190,381 | 45,630 |
| Expenditures: | | |
| General government expenditures | 1,707 | 1,702 |
| Investment expenditures | 1,201 | 558 |
| Total expenditures | <u>2,908</u> | <u>2,260</u> |
| Other financing sources (uses): | | |
| Transfer in - Commonwealth | 1,091,347 | 1,420,936 |
| Distribution – Pension Benefits Council (“PBC”) | (2,333) | (578) |
| Total other financing sources | <u>1,089,014</u> | <u>1,420,358</u> |
| Change in fund balance | 1,276,487 | 1,463,728 |
| Fund balance, beginning of year – restricted | 1,468,161 | 4,433 |
| Fund balance, end of year – restricted | <u>\$ 2,744,648</u> | <u>1,468,161</u> |

Required Supplementary Information –
Management’s Discussion and Analysis

June 30, 2024

(Unaudited)

Pension Reserve Trust Performance for Fiscal Year Ending June 30, 2024

The Trust began the fiscal year with \$1.469 billion in assets and took receipt of additional cash contributions in September and October 2023, totaling \$1.091 billion. In accordance with the Trust’s Investment Policy Statement and by using a risk-management based, phased-in approach, the Trust invested the additional capital into Exchange-Traded Funds (ETFs), index mutual funds, and cash equivalent instruments making up the long-term investment strategy.

The Trust ended the fiscal year with \$2.744 billion in assets, adding over \$187 million in earnings during FY24. As of June 30, the ending assets were invested almost among Vanguard, State Street, Schwab, iShares, SPDR, and Aberdeen ETFs, and a Money Market Treasury Fund with Northern Trust, the Pension Reserve Trust’s custodian bank. As a result, the Trust’s financial position has improved when compared to the prior fiscal year.

For the fiscal year ending June 30, 2024, the Pension Reserve Trust earned 6.4%, net of fees. This rate outperformed the Policy Index return of 5.7% and the actuarial assumed rate of return of 4.5%².

The Trust’s Investment Policy Statement and long-term asset allocation strategy is as follows: High Quality Fixed Income 55%, Equity 25%, Credit 10%, and Diversification 10%. The policy defines these as follows:

HIGH QUALITY FIXED INCOME: US treasury bills, bonds, & notes, federal agency debt, discount notes, money market funds and other similar instruments, investment grade U.S. dollar denominated corporate bonds.

EQUITY: Investments include public market stocks.

CREDIT: Investments include global fixed income, below investment grade corporate bonds, and private credit.

DIVERSIFICATION: Investments include public market real assets, private real estate, and tactical asset allocation strategies.

Other Information

This financial report is designed to provide a general overview of the PRT’s financial results. Additional information can be found on the PRT Board’s website at www.prtpr.org. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Pension Reserve Trust Board via e-mail through comments@prtpr.org or by mail to B5 Tabonuco Street, Suite 216, PMB 355, Guaynabo, Puerto Rico 00968.

² Based on the Commonwealth’s Certified Fiscal Plan dated January 27, 2022.

Balance Sheet
June 30, 2024
(Dollars in thousands)

| | 2024 |
|--|--------------|
| Assets: | |
| Current assets | |
| Cash and cash equivalents | |
| Cash - operational | \$ 829 |
| Cash equivalent held in money market account | 90,218 |
| Investments at fair value | |
| Fixed Income | 1,705,921 |
| Equity | 921,667 |
| Commodity | 26,413 |
| Other current assets | 84 |
| Total current assets | 2,745,132 |
| Noncurrent assets | |
| Property, plant & equipment – net | 13 |
| Operating lease right-of-use asset | 210 |
| Total assets | 2,745,355 |
| Liabilities: | |
| Current liabilities: | |
| Accounts payable | 65 |
| Accrued expenses | 406 |
| Personnel related payable | 21 |
| Current portion of operating lease liability | 23 |
| Withholding taxes | 5 |
| Total current liabilities | 520 |
| Operating lease liability | 187 |
| Total liabilities | 707 |
| Fund balance – restricted | \$ 2,744,648 |

The accompanying notes are an integral part of these financial statements.

Statement of Revenues, Expenditures, and Change in Fund Balance

For the Fiscal Year Ended June 30, 2024

(Dollars in thousands)

| | <u>2024</u> |
|--|---------------------|
| Revenues: | |
| Interest Income | \$ 91,859 |
| Net change in unrealized appreciation on investments | 98,522 |
| Total revenues | <u>190,381</u> |
| Expenditures: | |
| General government | |
| Personnel related | 734 |
| Trustees | 272 |
| Legal counsel | 73 |
| Accounting and audit | 90 |
| Other professionals | 46 |
| Administrative | 81 |
| Travel & other reimbursable expenses | 58 |
| Depreciation | 7 |
| Start-up costs | 346 |
| Total general government expenditures | <u>1,707</u> |
| Investment expenditures | |
| Custodian | 76 |
| D&O insurance policy | 89 |
| Investment consultant & OCIO | 941 |
| Regulatory & Compliance | 95 |
| Total investment expenditures | <u>1,201</u> |
| Total expenditures | <u>2,908</u> |
| Other financing sources (uses): | |
| Transfer in – Commonwealth | 1,091,347 |
| Distribution – Pension Benefits Council (“PBC”) | (2,333) |
| Total other financing sources | <u>1,089,014</u> |
| Change in fund balance | 1,276,487 |
| Fund balance, beginning of year – restricted | <u>1,468,161</u> |
| Fund balance, end of year – restricted | <u>\$ 2,744,648</u> |

The accompanying notes are an integral part of these financial statements.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(1) Description of the Pension Reserve Trust

Pursuant to the Modified Eighth Amended Title III Joint Plan of Adjustment of the Commonwealth of Puerto Rico (the "Plan"), the Government of Puerto Rico (the "Government"), and the Financial Oversight and Management Board for Puerto Rico ("FOMB") have established the Commonwealth Plan of Adjustment Pension Reserve Trust (the "Pension Reserve Trust" or the "Trust") to provide financial support for the Government's pension obligations under the pay-as-you-go pension system (the "PayGo System") created pursuant to the provisions of Act 106 of August 23, 2017. The Pension Reserve Trust is a Puerto Rico irrevocable public trust duly organized due to the execution of that certain Deed of Public Trust (the "Deed of Trust"), effective as of March 14th, 2022, pursuant to the provisions of Chapter III of Act 219 of August 31st, 2012, as amended (the "Trust Act").

As outlined in the Deed of Trust and the Guidelines, the Pension Reserve Trust is an independent and separate legal entity from the Government. The Government has the obligation to provide the Trust with initial funding, an annual base contribution (the "Annual Contribution"), and an additional contribution based on the Government surplus (the "Additional Contribution") while remaining responsible for all pension payments, current and future. The Trust is overseen by a five-person board of trustees (the "Pension Reserve Board" or the "Board"), which is tasked with providing independent and professional management of the Trust's assets. Assets under the Trust are irrevocably held by the Board for the exclusive purposes of: (i) paying the operating and administrative expenses of the Trust and the Pension Benefits Council, and (ii) making disbursements to the Government as the Trust's sole beneficiary pursuant to the Guidelines.

An additional entity composed of nine members appointed by different key stakeholders, and some elected by eligible retirees (the "Pension Benefits Council" or the "Council") was established for the purpose of ensuring the Government's compliance with the Plan of Adjustment and the Guidelines in funding the Pension Reserve Trust through annual contributions and shall, along with the Pension Reserve Board, administer requests by the Commonwealth to withdraw funds from the Trust.

Over the next decade, after the close of each fiscal year, the Commonwealth must make deposits to the Pension Reserve Trust based on the annual surplus from the most recent fiscal year. The Annual Contributions are expected for a duration of ten (10) fiscal years, with the final payment anticipated to occur based on the fiscal year ending on June 30, 2031. Most of the deposits are expected to be received as a base contribution by October 1 of each year, although the Additional Contribution is contingent on the economic performance of Commonwealth and may not be known until November of each year. The Trust will commence transferring funds back to the Commonwealth no earlier than 2032, as required to assist the Commonwealth in meeting its pension obligations.

On March 22, 2024, the Title III Court approved the Final Stipulation Concerning Act 80 of 2020 and Joint Resolution 33 of 2021 (the "Final Stipulation"). Pursuant to Section 83.2(c) of the Central Government's Plan of Adjustment, FOMB and the Government agreed to make additional contributions into the Pension Reserve Trust (the "Act 80 Contributions") that will be deposited into the Trust on a monthly basis between fiscal years 2025 and 2031.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(2) Summary of Significant Accounting Policies**(a) Basis of Accounting and Financial Statement Presentation**

The preparation of these financial statements is in conformity with generally accepted accounting principles in the United States of America as promulgated for governmental funds by the Governmental Accounting Standards Board. The financial activities of the Pension Reserve Trust are reported as part of the Commonwealth's general fund in the Commonwealth's financial statements. For its reporting purposes, the Trust has presented only governmental fund financial statements, which are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenue is recognized as soon as it is both measurable and available, and net of amounts considered not collectible. 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.

The Trust's assets are restricted assets of the Commonwealth and represent only the portion of the Commonwealth's General Fund related to the Trust; therefore, the basic financial statements of the Trust are not intended to present the financial position or changes in financial position of the Commonwealth as a whole in conformity with U.S. generally accepted accounting principles.

(b) Cash and Cash Equivalents

Cash and cash equivalents include deposits and short-term investments held in the Trust's operating bank accounts and custodian bank. Short-term investments include cash held in short-term investment funds and other highly liquid investments. Short-term investments considered cash are recorded at cost, which approximates fair value.

(c) Transfers from the Commonwealth of Puerto Rico

The Commonwealth's Annual Contributions to the Trust are recognized as an other financing source when received.

(d) Distributions to the Pension Benefits Council

Funding of the Council's administrative and operating budget by the Trust is recognized as an other finance use when paid.

(e) Investments

Investment securities are carried at fair value, except for money market investments, which are carried at cost. Fair value is determined based on quoted market prices and quotations received from independent broker/dealers or pricing service organizations. Such quoted market prices are obtained from independent sources.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

Security transactions are recorded on the date the securities are purchased or sold. The cost of a security is the purchase price. The calculation of realized gains (losses) is independent of the calculation of the net change in unrealized appreciation (depreciation) on investments. Realized gains and losses on investments sold in the current year include previously recorded unrealized amounts and are included in net realized gain on investments within the financial statements.

(f) Prepaid Expenses

Expense items of a nature which will benefit future periods are charged to the prepaid expense accounts and are amortized over the term of the expenditure.

(g) Property and Equipment

Property and equipment are stated at cost. Expenditures for repairs and maintenance are charged to operations as incurred, whereas major betterment are capitalized. Depreciation and amortization are computed by the straight-line method based on the estimated useful life of the equipment, but not exceeding the allowed depreciation for tax purposes. They are tested for recoverability whenever events or circumstances indicate that the carrying amount of the asset group may not be recoverable. If the asset group is not recoverable, its carrying amount is reduced to its fair value. The major category of property and equipment included within these financial statements is furniture and equipment, which is depreciated on a straight-line basis using a three-year estimated useful life.

(h) Investment Income

Interest income is recognized on an accrual basis using the effective interest method, which allocates interest income over the relevant period to reflect a constant periodic rate of return on the asset's carrying amount.

(i) Use of Estimates

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

(j) Fund Balance

Fund balance is reported as restricted when constraints placed on the use of resources are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or imposed by law through constitutional provisions or by enabling legislation. As the assets held by the Trust are restricted to provide financial support for the Government's pension obligations under the PayGo System in accordance with the Guidelines, and to pay the expenses of the Pension Reserve Board and the Pension Benefits Council, the Trust classifies fund balance as restricted.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(k) New Accounting PronouncementGASB Statement No. 100

In June 2022, GASB issued Statement No. 100, *Accounting Changes and Error Corrections*. The objective of this Statement is to enhance accounting and financial reporting requirements for accounting changes and error corrections to provide more understandable, reliable, relevant, consistent, and comparable information for making decisions or assessing accountability. This Statement requires disclosure in notes to financial statements of descriptive information about accounting changes and error corrections, such as their nature. In addition, information about the quantitative effects on beginning balances of each accounting change and error correction should be disclosed by reporting unit in a tabular format to reconcile beginning balances as previously reported to beginning balances as restated.

Furthermore, this Statement addresses how information is affected by a change in accounting principle or error correction should be presented in required supplementary information (RSI) and supplementary information (SI). For periods that are earlier than those included in the basic financial statements, information presented in RSI or SI should be restated for error corrections, if practicable, but not for changes in accounting principles.

(l) Future Accounting Pronouncements – Issued But Not Yet Effective

The Trust's management is currently evaluating the impact on the financial statements, if any, for the following GASB statements:

GASB Statement No. 101

In June 2023, GASB issued Statement No. 101, *Compensated Absences*. The objective of this Statement is to better meet the information needs of financial statement users by updating the recognition and measurement guidance for compensated absences. That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. The requirements of this Statement are effective for fiscal years beginning after December 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

GASB Statement No. 102

In December 2023, GASB issued Statement No. 102, *Certain Risk Disclosures*. The objective of this Statement is to provide users of government financial statements with essential information about risks related to a government's vulnerabilities due to certain concentrations or constraints. The requirements of this Statement are effective for fiscal years beginning after June 15, 2024, and all reporting periods thereafter. Earlier application is encouraged.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(3) Fair Value Measurements of Investments

GASB Statement No. 72, *Fair Value Measurement and Application*, (GASB No. 72), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and consider the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. By contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument.

In accordance with GASB No. 72, the Trust categorizes the fair value measurements of its investments within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy categorizes the inputs to valuation techniques used for fair value measurement into three levels as follows:

- Level 1 – Inputs that reflect quoted prices (unadjusted) in active markets for identical assets or liabilities that the fund can access at the measurement date. An active market is one in which transactions for the assets occur with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Inputs other than quoted prices that are observable for an asset or liability either directly or indirectly, including inputs in markets that are not considered to be active. Fair values are primarily obtained from third-party pricing services for identical or comparable assets or liabilities, such as interest rates, foreign exchange rates, and yield curves that are observable at commonly quoted intervals.
- Level 3 – Significant unobservable inputs, for example, inputs derived through extrapolation that cannot be corroborated by observable market data. These will be developed based on the best information available in the circumstances. Level 3 inputs will consider the assumptions that market participants would use in pricing the asset, including assumptions about risk (e.g., credit risk, model risk, etc.).

The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs. In certain instances where the determination of the fair value measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

The estimated fair value may be subjective in nature and may involve uncertainties and matters of significant judgment for certain financial instruments. Changes in the underlying assumptions used in calculating fair value could significantly affect the results. Therefore, the estimated fair value may materially differ from the value that could be realized on sale.

The inputs and methodology used for valuing securities or level assigned are not necessarily an indication of the risk associated with investing in those securities.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

The following is a summary of the portfolio by inputs used as of June 30, 2024, in valuing Pension Reserve Trust's investments carried at fair value:

| Investments at fair value | 2024 | | | |
|----------------------------|---------------------|--|---|---|
| | Total | Fair value measurements using | | |
| | | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs or not redeemable (Level 3) |
| Equities: | | | | |
| Domestic Equity | 688,938 | 688,938 | - | - |
| International Equity | 232,729 | 232,729 | - | - |
| | <u>921,667</u> | <u>921,667</u> | <u>-</u> | <u>-</u> |
| Fixed Income: | | | | |
| Domestic Fixed Income | 1,679,649 | 1,679,649 | - | - |
| International Fixed Income | 26,272 | 26,272 | - | - |
| | <u>1,705,921</u> | <u>1,705,921</u> | <u>-</u> | <u>-</u> |
| Commodities | 26,413 | 26,413 | - | - |
| Total Investments | <u>\$ 2,654,001</u> | <u>\$ 2,654,001</u> | <u>\$ -</u> | <u>\$ -</u> |

(4) Deposits and Investments Risks**(a) Credit Risk**

Custodial credit risk is the risk that in the event of bank failure, the Pension Reserve Trust's deposits may not be returned. The Trust maintains cash with Banco Popular de Puerto Rico, a major financial institution in Puerto Rico. The combined account balances at a specific financial institution may periodically exceed federally insured limits. The Trust does not have a deposit policy for custodial credit risk. As of June 30, 2024, the Trust's operational bank balance was \$829, and \$579 of that amount was exposed to custodial credit risk because it was uninsured and uncollateralized. The Trust, through its consultants, monitors the credit quality of the financial institutions and does not anticipate its nonperformance.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Trust will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Trust maintains its investments with Northern Trust, which employs a Global Enterprise Risk Committee to provide oversight and guidance related to risk management strategies, policies, and tolerance levels, including those for credit risk.

(b) Market Risk

Since the purpose of the Trust is to provide funds as necessary beginning FY 2032, the initial time horizon for investments is long-term, and investments will be made with the goal of meeting those needs when they ultimately occur. Capital values fluctuate. The Board recognizes that the risk of capital loss is inherent in any investment program seeking an investment return and that investment losses will occur from time to time. To minimize the risk that these fluctuations prevent the Trust from meeting its ultimate objectives, fund assets will be invested in a prudent manner to ensure diversification of investment risks and opportunities.

The Board recognizes that risk must be assumed to achieve the Trust's long-term investment objectives. The Board also understands that the nature of financial instruments and the markets in which it invests involve fluctuations in market value and rates of return. The Board will aim to meet these objectives and limit risk by its asset allocation, and by diversifying assets across asset classes and investment managers.

(c) Concentration of Credit Risk

GASB Statement No. 40 *Deposit and Investment Risk Disclosures* establishes certain disclosure requirements related to investment risks including, but not limited to, concentration of credit risk. As part of this disclosure, an entity should provide information about the concentration of credit risk associated with their investments by disclosing, by amount and issuer, investments in any one issuer that represents 5 percent or more of total investments. Investments issued or explicitly guaranteed by the U.S. Government, and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement.

The Board, with the assistance of its investment advisor, manages the Trust's exposure to concentration of credit risk by establishing guidelines that limit the percentage of investment in any single issue or issuer. At June 30, 2024, the Trust has no investments at fair value, other than those excluded from this requirement, that exceed 5% of the Trust's total investments.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(5) Property, Plant & Equipment

As of June 30, 2024, net property, plant, and equipment balances are as follows:

| | |
|-----------------------------------|--------------|
| Furniture and Equipment | \$ 22 |
| Less: Accumulated Depreciation | 9 |
| Net property, plant and equipment | <u>\$ 13</u> |

(6) Investment Management and Other Management Fees

Expenses incurred in managing the Trust are charged to the Pension Reserve Trust. These expenses consist of investment advisory fees, custodian fees, council fees, and professional fees, as well as staff salaries and other administrative expenses of the Board.

(a) Investment Advisory Fees

NEPC, LLC ("NEPC") served as the Board's principal investment advisor and Outsourced Chief Investment Officer ("OCIO") in fiscal year 2024. The investment advisors provided the Board with comprehensive investment advisory services, including recommendations on asset allocation, selection of investment managers, and the monitoring of performance of the Pension Reserve Trust.

For the year ended June 30, 2024, The Trust incurred \$941 in investment advisory fees, which are included in investment consultant fees and investment consultant & OCIO annual fee in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(b) Custodian Fees

Northern Trust has served as the investment custodian for the Trust since April 3, 2023. During this time, Popular Fiduciary Services and Northern Trust performed all daily transactions, including investment purchases and sales, investment income and expenses for the Trust.

For the year ended June 30, 2024, The Trust incurred \$76 in custodian fees, and are included in investment custodian fees in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(c) Pension Benefit Council Expenses

As provided in Section 1.7 of the Guidelines, the Pension Reserve Board shall promptly transfer appropriate sums into the account for administrative and operating expenses of the Pension Benefits Council for the payment of the Pension Benefits Council's expenses. For the year ended June 30, 2024, the Pension Benefit Council's expenses amounted to \$2,333 and are included as "Distribution - Pension Benefits Council ("PBC")" in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(d) Other Administrative Fees

For the year ended June 30, 2024, other administrative expenses of the Board, including employee compensation, trustee compensation, legal and other professional fees totaled \$1,707, and are included in the accompanying Statement of Revenues, Expenditures, and Change in Fund Balance.

(7) Description of Leasing Arrangements

The Trust leases an office under an operating lease with 10-year initial terms. While the agreement provides for minimum lease payments, it includes payments adjusted for inflation or for variable payments regarding proportional share of insurance and other common expenses. Variable payments are not determinable at lease commencement and are not included in the measurement of the lease assets and liabilities. The lease agreement does not include any material residual value guarantees or restrictive covenants.

The following summarizes the line items in the balance sheet, which include amounts for operating leases, as of June 30, 2024:

| | | |
|---|----|------------|
| Operating lease right-of-use assets | \$ | 210 |
| Current portion of long-term debt of operating lease liabilities | | 23 |
| Operating lease liabilities | | 187 |
| Total operating lease liabilities | \$ | <u>210</u> |

The components of operating lease expenses that are included in "Administrative" in the Statement of Revenues, Expenditures and Change in Fund Balance for the year ended June 30, 2024, were as follows:

| | | |
|----------------------|----|----|
| Operating lease cost | \$ | 29 |
| Variable lease cost | \$ | 25 |

The maturities of operating lease liabilities as of June 30, 2024, were as follows:

| | | |
|----------------------|----|------------|
| Year ending June 30, | | |
| 2025 | \$ | 23 |
| 2026 | | 23 |
| 2027 | | 23 |
| 2028 | | 23 |
| 2029 | | 23 |
| Thereafter | | 95 |
| Total | \$ | <u>210</u> |

Notes to the Fund Financial Statements

June 30, 2024

(Dollars in thousands)

(8) Subsequent Events

On August 7, 2024, September 5, 2024, October 16, 2024, and November 13, 2024, the Pension Reserve Trust received the monthly Act 80 Contribution due from the Government, each in the amount of \$1,547.

On September 30, 2024, the Pension Reserve Trust received the Annual Contribution for fiscal year 2025 due from the Government in the amount of \$906,035.

The Pension Reserve Board, the Pension Benefits Council, the Commonwealth of Puerto Rico and the Federal Management Oversight Board for Puerto Rico ("FOMB"), as sole Title III representative of the Commonwealth under the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"), as codified in 48 USC §§2101-2241, have unanimously agreed to amend and/or clarify certain provisions of the Deed of Trust and the Guidelines. Consequently, on October 16, 2024, a Motion of The Financial Oversight and Management Board for Puerto Rico For Order Pursuant To Bankruptcy Code Section 1142 In Aid Of Plan Implementation to that respect has been filed by the FOMB on behalf of all relevant parties before the United States District Court for the District of Puerto Rico.