



GOVERNMENT OF PUERTO RICO
OFFICE OF MANAGEMENT AND BUDGET

May 6, 2026

BY ELECTRONIC MAIL

Mr. Robert F. Mujica, Jr.
Executive Director
Financial Oversight and Management Board for Puerto Rico

Re: Response to the Notice of Violation – Revised Proposed FY 2027 Commonwealth Budget

Dear Mr. Mujica:

The Government of Puerto Rico (“Government”), through the Office of Management and Budget (“OMB”), respectfully submits this response to the Notice of Violation issued by the Financial Oversight and Management Board for Puerto Rico (the “Oversight Board”) on April 24, 2026, regarding the Updated Proposed FY2027 Commonwealth Budget. This communication accompanies the Revised Proposed FY 2027 Budget (the “Revised Budget”), reflected in the General Fund Joint Resolution, which was delivered in advance of this letter on May 2, 2026, and prepared by OMB in close coordination with the Oversight Board’s staff.

This letter address each of the matters raised by the Oversight Board, including (i) the recognition of the Government’s analytical methodology, (ii) the funding adequacy of the operating risks identified in Appendix A of the Notice of Violation, (iii) the acceptance and incorporation of the Oversight Board’s input, and (iv) the application of modified accrual budgeting principles within the Revised Budget.

I. Acknowledgment of the Collaborative Process

The mutual working sessions held throughout the FY 2027 budget formulation process, particularly the discussions regarding agency operations, funding priorities, and fiscal risks, contributed to developing a shared understanding of the Commonwealth’s operational realities and to ensuring alignment with the long-term fiscal sustainability objectives reflected in the Certified Revised 2024 Commonwealth Fiscal Plan (“Certified Fiscal Plan”).

The Government recognized the effort and collaboration demonstrated by both the Oversight Board and OMB teams during the iterative submission cycle of March 6, March 17, March 27,

April 21, and May 1, 2026. These exchanges supported meaningful progress toward a budget submission that fully aligns with the FY 2027 General Fund target of **\$13,180,532,000**.

II. Methodology: Historical and Comparative Analyses

The Government appreciates the Oversight Board's recognition that “the Government used historical and comparative analyses throughout development of the Proposed FY 2027 Commonwealth Budget to identify potential reductions in spending, primarily **to fund a special stabilization reserve and a risks and initiatives fund**.” This methodological approach is grounded in the budgetary discipline framework set forth in the Government of Puerto Rico Budget Process Manual (*Manual del Proceso Presupuestario del Gobierno de Puerto Rico* hereinafter the “Budget Manual”), which requires the rigorous identification of recurring versus non-recurring expenditures, as well as the disciplined evaluation of each agency's operational baseline against historical execution patterns.

It is precisely the rigor of these historical and comparative trends, produced by OMB through the Integrated Data System (“SID”, by its Spanish acronym), OMB's central platform for real-time fiscal intelligence, together with each agency's actual execution data, that gives the Government confidence that no material operating risks remain unfunded in the Revised Budget.

As described in the Government's March 6, 2026 budget submission, SID integrated historical expenditure data, payroll execution patterns, and vendor payment activity into a unified analytical environment, enabling OMB to evaluate each agency-level proposal against documented operational behavior, including consistent under-execution patterns in payroll, professional services, purchased services, and equipment purchases across multiple agencies, rather than relying on discretionary assumptions. Where this trend analysis identified reductions that, in the Oversight Board's view, could pose risks if actual costs exceed projections, the Government did not eliminate the underlying budgetary capacity. Instead, as a precautionary measure consistent with sound fiscal management, those resources were redirected to the **Reserve for Budget Stabilization and the Risk Reserve**. These mechanisms keep funding available to address operational pressures that may arise during the fiscal year and reinforce the Commonwealth's overall fiscal stability.

III. Risk Identification and Funding Adequacy

The Government has carefully reviewed the operating risks identified by the Oversight Board in Appendix A of the Notice of Violation, including those associated with the Emergency and Disaster Management Bureau, the Institute of Forensic Sciences, Correctional Health, the Medical Emergency Corps Bureau, the Puerto Rico Planning Board, the State Elections Commission, General Services Administration, and the Puerto Rico Department of Justice, among others.

The Government respectfully maintains that the Revised Budget, taken as a whole, adequately addresses these risks through three complementary mechanisms:

1. Adequate baseline funding at the agency level: calibrated against multi-year execution data, the Certified Fiscal Plan targets, and each agency's documented operational requirements;
2. The Risk Reserve: established under Section 4 of the General Fund Joint Resolution, specifically designed to cover additional operating needs identified during the fiscal year, subject to the Oversight Board's approval; and
3. The Reserve for Budget Stabilization: established pursuant to Section 18 of the General Fund Joint Resolution, which strengthens fiscal resilience and enables the Commonwealth to respond appropriately to revenue cycles and unforeseen operating pressures.

The combination of agency-level baseline funding with these centralized reserves reflects the Government's deliberate decision to maintain a fiscally disciplined and adaptable framework rather than fragmenting contingency capacity across individual agency budgets.

IV. Acceptance of the Government's Proposed Reductions

The Oversight Board's acknowledgment that, "after engaging with the Government, the Oversight Board was able to accept several of the Government's proposed reductions to agency budgets despite concerns that some reductions could pose risks if actual costs exceed projections." With respect to that concern, the Government respectfully notes that, should actual costs exceed projections, any such variance may be addressed in real time through the Risk Reserve. However, long-term budget planning will recurrently reflect the adjustments made to certain expenditure categories. This outcome will be reflected in the financial plan that the Government will be developing collaboratively with the Oversight Board. Where the parties have differed on individual line items, those differences have been addressed through the collaborative resubmission process and are documented in detail in **Annex A**.

V. Incorporation of the Oversight Board's Input – Updated Proposed Budget

Consistent with the collaborative approach of the FY 2027 budget development process, the Government received the Oversight Board's concerns and prepared a Revised Budget that incorporates the agreed-upon revisions. In fact, the Revised Budget transmitted herewith reflects the further discussions held through May 1, 2026, regarding the distribution of remaining unallocated capital expenditures and the alignment of the General Fund Joint Resolution with the Revised Budget, as summarized in Appendix C of the Notice of Violation.

The Revised Budget maintains the FY 2027 General Fund total of \$13,180,532,000, fully aligned with the Oversight Board's target, while incorporating internal reallocations across approximately 18 agencies. The aggregate variance among those agencies is zero, and the principal substantive movements are summarized in Annex A. These movements reflect, among other items: (i) a new repaving line under the Department of Transportation and Public Works for \$25.5 million; (ii) a new Electronic Medical Record initiative under the Department of Health for \$5.0 million; (iii) a contractual adjustment for the HMS Ferries operator under the Integrated Transportation Authority

for \$11.1 million; (iv) an internal reclassification of \$21.0 million between Civil Service Reform and salary adjustment payroll lines under the Custody of OMB; (v) capital expenditure refinements consistent with project execution timelines; and (vi) a redistribution of media advertising and public relations funding across 14 agencies.

VI. Application of Modified Accrual Accounting Standards

The Government has carefully considered the Oversight Board's observation that, "although the Updated Proposed FY 2027 Commonwealth Budget complies with the Certified Revised 2024 Commonwealth Fiscal Plan, it is non-compliant in that it was not developed using modified accrual accounting standards, which are the agreed-upon accounting standards for the General Fund."

As part of this process, we have implemented a memorandum related to the accounting treatment of the Budget based on the Modified Accrual standard. Therefore, the FY 2027 General Fund Budget has been developed in a manner that is functionally consistent with the modified accrual budgeting principles articulated by the Governmental Accounting Standards Board ("GASB"). This marks the first time since the establishment of the Oversight Board that OMB has submitted a budget in compliance with this standard, based on the memorandum included as **Annex B**.

The General Fund Joint Resolution accompanying the Revised Budget operationalizes this framework through, among other mechanisms, the availability criterion at the appropriation level (Section 5), the quarterly revenue re-projection requirement (Section 8), the 3% withholding mechanism conditioned on actual revenue performance (Section 3), the use of encumbrance accounting for prior-year carryovers (Section 9), the prior-period certifications attesting that no prior-year appropriation has been used to cover current-period expenses (Sections 10 and 16), the GASB Statement No. 54 fund-balance classifications reflected in the Reserve for Budget Stabilization, the Emergency Reserve, and the Risk Reserve (Sections 17 and 4), and the explicit recognition of federal grants and Maintenance-of-Effort obligations (Sections 15 and 20). These mechanisms, taken together with the framework required by the Budget Manual, embed the substantive controls, recognition principles, and fund-balance classifications of the modified accrual framework into the budget itself.

A complete technical analysis of how the Revised Budget aligns with the Modified Accrual Accounting Standards defined under Section 5(16) of PROMESA, including the quantitative reconciliation between cash collections and modified accrual revenue recognition; the treatment of payroll, operating expenses, federal funds, capital expenditures, reserves, consent decrees, and debt service; and the planned implementation of the Commonwealth's Enterprise Resource Planning (ERP) system aligned with modified accrual principles, is set forth in the accompanying Memorandum on the Application of Modified Accrual Accounting Standards to the Revised Budget (the "MAAS Memorandum"), which is incorporated herein by reference. Accordingly, a detailed analysis that includes the full MAAS Memorandum as supporting documentation for the application of modified accrual principles in the Revised Budget is provided in **Annex B**.

VII. Conclusion

The Government reaffirms its commitment to fiscal discipline, transparency, and full compliance with PROMESA and the Certified Revised 2024 Commonwealth Fiscal Plan. The Revised Budget transmitted with this letter aligns with the FY 2027 General Fund total of \$13,180,532,000 and reflects the substantive input received from the Oversight Board throughout the resubmission process.

We look forward to continuing the collaborative work with the Oversight Board to certify the FY 2027 Commonwealth Budget by June 30, 2026.

Cordially,



Orlando Rivera Berríos
Director
Office of Management and Budget

CC: Hon. Jenniffer González-Colón, Governor of Puerto Rico
Hon. Ángel Pantoja Rodríguez, Secretary of the Treasury
Lcdo. Francisco J. Domenech Fernández, Executive Director, AAFAF

Enclosures:

- Annex A – Summary of Variances
- Annex B- MAAS Memorandum
- Preliminary Draft – Government Accounting Manual of Puerto Rico (Manual de Contabilidad Gubernamental de Puerto Rico)



ANNEX A

Summary of Variances Between FOMB Revised Proposed - NOV FY 2027 Budget and The Government Revised Proposed FY 2027 Budget

The following table summarizes, on an agency-level basis, the variances between the Oversight Board's Revised Proposed FY 2027 Commonwealth Budget – NOV and the Government's Revised Proposed FY 2027 Commonwealth Budget (“OMB Revised”), as reflected in the General Fund Joint Resolution. The aggregate General Fund total (\$13,180,532,000) is identical under both versions; the table presents only the agencies for which an internal reallocation is reflected.

1. Summary by Agency – General Fund

Agency	FOMB Reference	OMB Revised	Variance	Brief Description
Department of Public Safety (DPS)	\$186,553,000	\$156,443,000	\$(30,110,000)	Reduction reflecting payroll restructuring within the agency's operational baseline, with offsetting consolidation in the Shared Services sub-account.
Assignments under the Custody of OMB	813,557,000	838,178,000	24,622,000	Net increase reflects reallocation of capital improvements and aggregated allocations under OMB's custody, including funding for the Risk Reserve and stabilization mechanisms.
Integrated Transit Authority (ATI)	66,109,000	77,204,000	11,095,000	Increase in Purchased Services to fund the HMS Ferries operator contract.
Department of Health (DOH)	518,258,000	514,267,000	(3,991,000)	Capital improvements reprogramming: Medicaid IT Program (\$-7.9M); discontinued Arecibo Hygiene Lab move (\$-0.8M) and Margarita Hospital ER (\$-0.3M); new Electronic Medical Record initiative (\$+5.0M); minor adjustment in media advertising (\$-0.014M).
Department of Correction and Rehabilitation (DCR)	463,251,000	461,176,000	(2,075,000)	Removal of capital improvements line for repair, maintenance, and rehabilitation costs.
Office of Management and Budget (OMB)	25,999,000	27,884,000	1,885,000	Increase in operational allocations for OMB initiatives and projects.
Innovation and Technology Service (PRITS)	92,809,000	92,059,000	(750,000)	Decrease in media advertising and public relations allocation.
Administration for Socioeconomic Development of the Family (ADSEF)	101,970,000	101,520,000	(450,000)	Decrease in media advertising and public relations allocation.

Agency	FOMB Reference	OMB Revised	Variance	Brief Description
General Services Administration	19,029,000	18,925,000	(104,000)	Decrease in media advertising and public relations allocation.
Puerto Rico Department of Justice	154,197,000	154,101,000	(96,000)	Decrease in media advertising and public relations allocation.
Child Support Administration (ASUME)	25,722,000	25,712,000	(10,000)	Removal of media advertising and public relations allocation.
Caño Martín Peña ENLACE Project Corporation	11,190,000	11,184,000	(6,000)	Removal of media advertising and public relations allocation.
Institute of Puerto Rican Culture	18,417,000	18,412,000	(5,000)	Removal of media advertising and public relations allocation.
Commission of Investigation, Processing and Appeals	531,000	529,000	(2,000)	Removal of media advertising and public relations allocation.
Office for the Patient's Advocate	2,068,000	2,067,000	(1,000)	Removal of media advertising and public relations allocation.
Cooperative Development Commission of Puerto Rico	2,779,000	2,778,000	(1,000)	Removal of media advertising and public relations allocation.
TOTAL (agencies with variance)	\$2,502,439,000	\$2,502,439,000	\$ -	Aggregate net variance.

2. Selected Line-Item Detail by Agency

The following sub-tables present the principal line-item movements underlying the agency-level variances above.

2.1 Assignments under the Custody of OMB – Variance: \$24,621,000

Concept / Line Item	FOMB Reference	OMB Revised	Variance
Capital Improvements – Funds for Repaving Project (transferred from DTOP to OMB Custody)	\$0	\$25,545,000	\$25,545,000
Capital Improvements – Implementation and support for the ERP system	0	10,000,000	10,000,000
Capital Improvements – Acquisition of electronic vote counting machines for the upcoming elections	0	15,000,000	15,000,000
Capital Improvements – Phase 2 costs for the interview rooms for violence victims (AEP / Police)	0	6,658,000	6,658,000
Capital Improvements – YMCA PUESTA AL DÍA to rehabilitate facilities in Río Grande, Luquillo and San Juna	0	300,000	300,000
Capital Improvements – Unallocated capital improvements and equipment	36,127,000	10,239,000	(25,888,000)
Capital Improvements – Capital improvements related to economic development	5,000,000	0	(5,000,000)
Payroll - Civil Service Reform implementation	31,540,000	15,540,000	(16,000,000)
Asignaciones englobadas – OMB initiatives and projects	3,000,000	2,554,000	(446,000)
Other reallocations and net adjustments across concepts	737,890,000	752,342,000	14,452,000
TOTAL	\$813,557,000	\$838,557,000	\$24,621,000

2.2 Department of Health – Variance: \$(3,991,000)

Concept / Line Item	FOMB Reference	OMB Revised	Variance
Capital Improvements – Information Systems for the Medicaid IT Program	\$31,592,000	\$23,667,000	\$ (7,925,000)
Capital Improvements – Arecibo Hygiene Lab relocation	758,000	0	(758,000)
Capital Improvements – San Lorenzo Hospital Emergency Room construction	294,000	0	(294,000)
Capital Improvements – Electronic Medical Record	0	5,000,000	5,000,000
Media Advertising and Public Relations	446,000	432,000	(14,000)
TOTAL	\$33,090,000	\$29,099,000	\$(3,991,000)

2.3 Integrated Transit Authority (ATI) – Variance: \$11,095,000

Concept / Line Item	FOMB Reference	OMB Revised	Variance
Purchased Services – HMS Ferries – Guarantee Essential Services for the residents of Vieques and Culebra.	\$37,919,000	\$49,014,000	\$11,095,000
TOTAL	\$37,919,000	\$49,014,000	\$11,095,000

2.4 Department of Correction and Rehabilitation (DCR) – Variance: \$(2,075,000)

Concept / Line Item	FOMB Reference	OMB Revised	Variance
Capital Improvements – Repair, maintenance, and rehabilitation costs. <small>They will be addressed through the creation of a new Capital Fund.</small>	\$2,075,000	\$0	\$(2,075,000)
TOTAL	\$2,075,000	\$0	\$(2,075,000)

2.5 Media Advertising and Public Relations – Reallocation Across Multiple Agencies

Concept / Line Item	FOMB Reference	OMB Revised	Variance
Office of Management and Budget – <small>Training and educational initiatives related to budget reform, among others.</small>	\$307,000	\$2,192,000	\$1,885,000
Innovation and Technology Service (PRITS)	850,000	100,000	(750,000)
Administration for Socioeconomic Development of the Family (ADSEF)	590,000	140,000	(450,000)
General Services Administration	375,000	271,000	(104,000)
Department of Justice	250,000	154,000	(96,000)
Department of Health	446,000	432,000	(14,000)
Child Support Administration (ASUME)	10,000	0	(10,000)
Commission of Investigation, Processing and Appeals	2,000	0	(2,000)
Institute of Puerto Rican Culture	5,000	0	(5,000)
Office for the Patient's Advocate	1,000	0	(1,000)
Cooperative Development Commission	1,000	0	(1,000)
Caño Martín Peña ENLACE Project	6,000	0	(6,000)
TOTAL	\$2,843,000	\$3,289,000	\$446,000



ANNEX B

Application of Modified Accrual Accounting Standards to the FY2027 Commonwealth General Fund Revised Proposed Budget

This Memorandum on the Application of Modified Accrual Accounting Standards to the FY2027 Commonwealth General Fund Revised Proposed Budget (the “MAAS Memorandum”) is the technical companion to, and is incorporated by reference into Section VI of, the transmittal letter from the Office of Management and Budget (“OMB”) to the Financial Oversight and Management Board for Puerto Rico (“FOMB”) submitted in response to the Notice of Violation issued by the FOMB on April 24, 2026, in connection with the Updated Proposed FY2027 Commonwealth Budget. As described in the transmittal letter, the General Fund Joint Resolution accompanying the FY2027 Commonwealth General Fund Revised Proposed Budget (“FY2027 Budget”) operationalizes the Modified Accrual Accounting Standards (“MAAS”) framework through specific control mechanisms; this Memorandum sets forth, in detail, the technical basis on which the FY2027 Budget has been developed and evaluated for consistency with MAAS as defined in Section 5(16) of PROMESA, including the Generally Accepted Accounting Principles (“GASB”) pronouncements.

Section 209 of the Puerto Rico Oversight, Management, and Economic Stability Act (“PROMESA”) establishes the conditions required for the termination of the FOMB. Specifically, the FOMB must certify that the Government has met two conditions. The first condition requires that the Government has adequate access to short-term and long-term credit markets at reasonable interest rates to meet its borrowing needs. The second condition requires that the Government has developed its Budgets (as defined under PROMESA) for at least four consecutive fiscal years in accordance with MAAS, and that expenditures have not exceeded revenues in each of those four fiscal years, as determined under MAAS.

The definition of MAAS under PROMESA is consistent with Generally Accepted Accounting Principles (“GAAP”) for state and local governments, as established by the GASB. Section 5(16) of PROMESA defines MAAS as:

“Recognizing revenues as they become available and measurable and recognizing expenditures when liabilities are incurred, in each case as defined by the Governmental Accounting Standards Board, in accordance with generally accepted accounting principles.”

GASB Codification Section 1600 establishes that financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified

accrual basis of accounting. Under this framework, revenues are recognized in the accounting period in which they become available and measurable, and expenditures are recognized in the period in which the related fund liability is incurred, provided they are measurable, except for unmatured interest in long-term liabilities, which is recognized when due. Accordingly, under MAAS and consistent with GASB guidance, revenues are recognized when they are both earned and available. Similarly, expenditures are recognized when the related liability is incurred during the current fiscal year, provided they are expected to be liquidated with current available financial resources.

This memorandum sets forth the basis upon which the FY2027 Budget has been developed for statutory budgetary and fiscal control purposes and evaluated for consistency with MAAS for purposes of PROMESA Section 209.

While the budget is prepared on a statutory basis for planning and control purposes, it incorporates key elements of the modified accrual framework applicable to governmental funds. However, the strict application of MAAS to the budget formulation process is not practicable and may give rise to unintended implications. It is important to recognize that modified accrual principles were developed primarily for financial reporting purposes rather than for governmental budgeting; accordingly, reasonable variations in their application are to be expected.

The budget constitutes a one-year financial plan that provides estimates of revenues—consistent with the requirement that the budget be balanced—expenditures, and other financing uses. It serves as the primary instrument for implementing fiscal policy decisions and authorizing the expenditure of public funds within established legal, contractual, and policy constraints. Similarly, it is prospective in nature and is based on reasonable and supportable estimates derived from the Certified Fiscal Plan, historical financial data, agency documentation supporting expenditure projections and fiscal year estimates, prevailing economic conditions, and applicable legislative and policy frameworks. Accordingly, it does not represent actual financial results, but rather a structured financial plan intended to guide the allocation, management, and control of public resources throughout the fiscal year.

In addition to its planning function, the budget serves as a central fiscal control mechanism, supporting the monitoring of budgetary performance, ensuring adherence to expenditure limits, and facilitating compliance with balanced budget requirements and other applicable fiscal rules. It also promotes transparency and accountability by establishing an approved financial framework against which actual results are evaluated.

Given that the budget is inherently based on estimates, considerations of materiality are integral to its preparation and evaluation. In this context, materiality refers to the significance of an omission or misstatement that could reasonably be expected to influence the decisions or evaluations of users of the budget. Accordingly, while estimates may be subject to variation, emphasis is placed

on ensuring that such differences, individually or in the aggregate, do not result in material misstatements that would affect the overall assessment of the budget's compliance with applicable fiscal requirements.

The FY2027 Budget has been developed based on revenue projections derived from the Certified Fiscal Plan, which serves as the authoritative framework for financial projections. These estimates incorporate historical collection trends, macroeconomic indicators, and legislated revenue measures, and are intended to reflect amounts that are both measurable and reasonably expected to be available to finance expenditures within the fiscal period. The FY2027 Budget is presented under the modified accrual basis, and the following discussion further develops the understanding of its application.

Beyond the conceptual framework, and as summarized in Section VI of the accompanying transmittal letter, the General Fund Joint Resolution that accompanies the FY2027 Budget operationalizes the modified accrual measurement focus through several specific control mechanisms. Section 5 provides that appropriations dependent on the Sales and Use Tax allocation to the Municipal Administration Fund (excluding the debt portion), cigarette and rum distributions, and the Municipal Revenue Collection Center's 1.03% property tax "are entirely dependent on the level of revenues collected therefrom" and that "no expenditure, disbursement, pledge, or any other encumbrance of any such funds may be made until such time as the revenues are collected and accounted for in the books," thereby applying the availability criterion at the appropriation level. Section 3 conditions the release of the final three percent (3%) of each appropriation on the actual achievement of the General Fund revenue forecast through the first eight months of the fiscal year, ensuring that expenditure authority does not exceed the financial resources available during the period. Section 8 requires the Secretary of the Treasury to revise projected General Fund revenues no later than 45 days after the close of each quarter, based on actual collections, providing a continuous re-measurement of revenue availability that mirrors the modified accrual recognition framework.

One of the key requirements for compliance with the modified accrual basis is that revenues must be measurable and available. While revenue projections in the Certified Fiscal Plan are generally formulated using a cash-based methodology, an analysis of prior fiscal years was performed to evaluate the relationship between cash collections and revenues recognized under the modified accrual basis of accounting, as defined by the GASB. This analysis assessed the extent to which revenues satisfy the "measurable and available" criteria, including collection within the established availability period, as defined in the latest audited financial statements. The relevant excerpts are quoted below for reference:

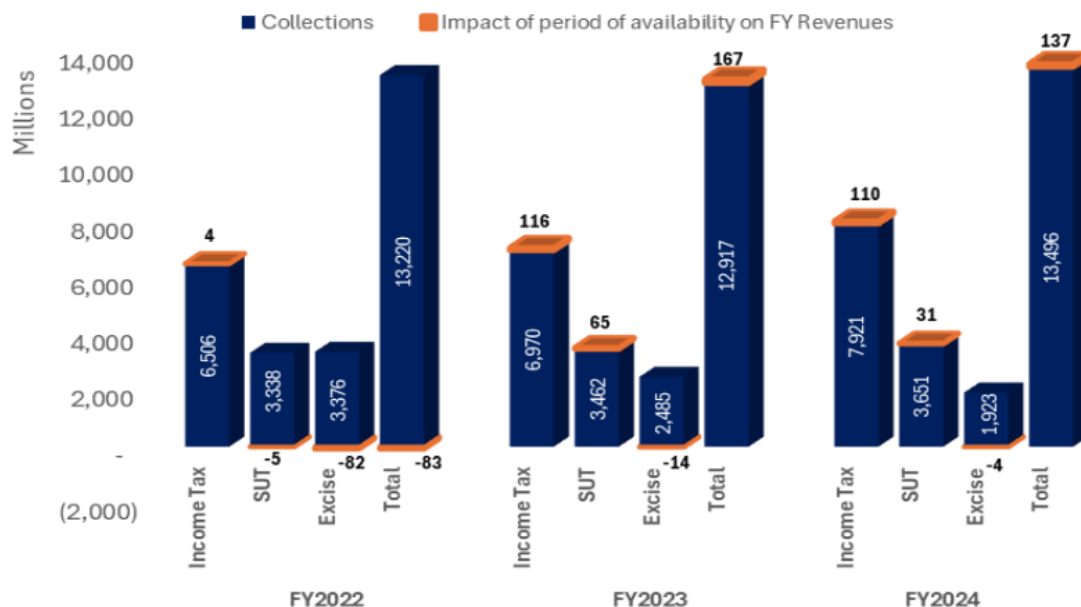
- “Income tax receivables in the General Fund are recognized as revenue when they become measurable and available based on actual collections during the 120 days following the current fiscal year-end that are related to taxable years of prior periods.”
- “The sales and use tax (“SUT”) receivable are recognized as revenue in the governmental funds when it becomes measurable and available based on actual collections during the 30 days following the current fiscal year-end related to sales and use transactions due on or before year end.”
- “Excise tax receivable is recognized as revenue in the governmental funds when it becomes measurable and available based on actuals collections during the 30 days following the current fiscal year-end related to transactions that occurred before year end.”

The results indicate that timing differences between cash collections and modified accrual recognition have not been material in relation to total revenues, because a substantial portion of collections is received within the current fiscal period or within the established availability periods used in the audited financial statements.

In addition, recent budget experience demonstrates the availability of unallocated or contingency amounts, including the practice whereby a portion of projected revenues is intentionally not fully allocated during the budget formulation process. Together with centrally managed reserves and other budgetary controls, including the 3% withholding requirement provided in Section 3 of the FY2027 Budget, these elements have historically provided a buffer against revenue and expenditure variances, consistent with prudent fiscal management practices, thereby supporting the maintenance of a structurally balanced budget. These mechanisms function as safeguards to absorb unforeseen fluctuations without resulting in imbalances.

Furthermore, the Government, in coordination with the FOMB, retains the ability to implement budgetary adjustments, including increases or reductions, as necessary to respond to changes in revenue projections, emerging fiscal needs, or other unforeseen circumstances that may impact budgetary balance. Such actions are undertaken in accordance with established fiscal governance and oversight processes to ensure continued compliance with balanced budget requirements.

Based on the foregoing, the FY2027 Budget revenue estimates are prepared in compliance with the modified accrual basis applicable to governmental funds for revenue recognition purposes and is structurally balanced, an outcome that the FOMB has acknowledged with respect to the Updated Proposed FY 2027 Commonwealth Budget. Refer to the graphic below comparing cash collections and the corresponding modified accrual revenue adjustments for the most significant General Fund revenue sources in prior fiscal years.



As observed from the analysis, the adjustments required to convert cash-based revenue projections to the modified accrual basis are not material in nature. It is important to reiterate that budgets are inherently based on reasonable and supportable estimates and, therefore, are subject to forecasting variability. Accordingly, a key element of sound fiscal management is ongoing monitoring to ensure that no unexpected events or changes materially affect the underlying assumptions on which the budget is based, including both revenue projections and expenditure estimates.

Expenditures in the FY2027 Budget represent the planned use of available financial resources for the current fiscal year, including payroll costs, operating expenses such as professional services, purchased services, donations, consent decree-related payments, as well as capital expenditures and other authorized programmatic outlays. As such, expenditure appropriations constitute prospective estimates of resource requirements necessary to carry out governmental operations and policy objectives within established legal, contractual, and fiscal constraints.

For the FY2027 Budget, the OMB evaluates each request submitted by Commonwealth agencies based on the agencies programmatic and legal commitments, operational priorities, fiscal constraints, available resources, government programs, Fiscal Plan initiatives, and historical trends from prior fiscal years.

The table below presents all expenditure concepts included in the FY2027 Budget. However, particular emphasis is placed on the major cost drivers, namely Payroll and related costs, Appropriations to non-governmental entities, Payments to PayGo, Social well-being for

Puerto Rico, and Debt service. Collectively, these categories represent approximately 76% of the FY2027 Budget. Given their materiality and relative weight, these components constitute the primary focus of budget analysis, review, and monitoring. Accordingly, particular attention is directed to their composition, underlying assumptions, and year-over-year behavior, as they largely determine the overall structure and fiscal profile of the budget. Other significant categories, including Facilities and utility payments, Purchased services, and Professional services, together with the previously described major components, represent approximately 89% of the FY2027 Budget. These categories also merit review given their operational importance and recurring nature, as they further support the execution of government functions and service delivery. Accordingly, the combined assessment of these components provides a comprehensive view of the budget's composition and key cost drivers, making clarity in their basis and presentation essential to ensure proper interpretation of the budget framework and avoid potential distortion of the overall financial picture.

Concept	Amount	%
Payroll and related Costs	\$ 3,595,784	27%
Facilities and utility payments	486,807	4%
Purchased services	583,564	4%
Other operating expenses	260,435	2%
Appropriations to non-governmental entities	1,336,703	10%
Payments to PayGo	2,036,581	15%
Undistributed appropriations	341,606	3%
Transportation	112,704	1%
Professional services	572,089	4%
Capital expenditures	133,230	1%
Materials and supplies	83,181	1%
Equipment purchases	75,834	1%
Media and advertisements	4,998	0%
Federal Fund matching	147,848	1%
Donations, subsidies and other distributions (including court sentences)	313,386	2%
Social well-being for Puerto Rico	2,045,557	16%
Payments of current and prior period obligations	2,586	0%
Debt service	1,047,639	8%
Total FY2027 General Fund Proposed Budget	\$ 13,180,532	100%

Under the modified accrual basis applicable to governmental funds, salaries and related cash compensation benefits are generally recognized as expenditures in the period in which the related services are rendered and the liability is incurred, provided that the amounts are expected to be liquidated with current financial resources. Accordingly, payroll expenditures are

recorded when employees earn compensation and associated benefits, rather than when payment is made, subject to the availability criterion applicable to governmental fund accounting.

For budgetary purposes, the annual compensation costs of each agency, including salaries, health insurance costs, overtime, leave-related benefits, and other personnel-related costs, are evaluated for current employees as well as any planned new recruitment. This analysis incorporates historical expenditure trends from prior fiscal years to ensure reasonable and supportable projections. As part of this process, consideration is given to workforce movements, including retirements and resignations occurring during the previous fiscal years, to appropriately adjust expected compensation costs within current estimates. In addition, periods of authorized leave, such as vacation and sick leave taken by employees during the fiscal year, are already contemplated within the annualized compensation costs included in the budget, as these costs are part of the normal cost of employment embedded in the annual salary budgeted.

Furthermore, the Christmas bonus is estimated based on the total expected number of eligible employees and the anticipated payout applicable for the FY2027 and is included as part of the overall compensation cost. Accordingly, all personnel-related costs are budgeted based on the full annual cost of employment and are expected to be covered with current available resources, as established by MAAS. Non-cash payroll-related items are not included as part of the FY2027 Budget.

For operating expenses, including professional services, purchased services, and other related expenditures, all existing contracts were evaluated to determine their continuity into FY2027, in addition to approved initiatives and programmatic requirements. This analysis also incorporates the required 3% reduction applicable to all government entities, as established in the OMB Special Memorandum 012-2025, to develop the FY2027 Budget allocations, as well as an inflation factor generally considered as part of the evaluation of expected cost levels. Accordingly, operating expense estimates are based on a comprehensive review of contractual obligations, policy directives, and efficiency measures, which are expected to impact FY2027, to ensure alignment with available funding and fiscal constraints. Furthermore, utility costs are estimated based on information provided by entities such as PREPA, PRASA, and PRIMAS, among others, which reflect expected market conditions and projected consumption of services during the fiscal year. This approach is consistent with the modified accrual basis, under which expenditures are recognized in the period in which the related liabilities are incurred and are expected to be liquidated with current available financial resources, thereby ensuring that budgeted amounts reflect obligations anticipated to arise within the fiscal period. With respect to federally funded programs, including, among others, the Disaster Relief Fund, FEMA Public Assistance and Mitigation cost-share, and the Medicaid program, Sections 15 and 20 of the General Fund Joint Resolution and the Government of Puerto Rico Budget Process Manual require that federal grants and cost-share programs be budgeted with explicit recognition of the Commonwealth's

Maintenance-of-Effort (“MOE”) and matching obligations, together with the multi-year impact of federal program timing. Accordingly, the FY2027 Budget reflects these federal commitments as obligations against current and projected fiscal capacity, consistent with the modified accrual recognition of expenditure when the underlying matching commitment requires the use of current financial resources during the period.

Pension obligations, which have been restructured under PROMESA, are no longer reported as fiduciary funds in the financial statements but are instead reflected within governmental funds and funded on a pay-as-you-go (PayGo) basis under the *Payments to PayGo* category. For the FY2027 Budget, amounts are based on the payments expected to be made during the fiscal year, in accordance with the established payment schedule. Accordingly, the budget includes the costs associated with current pension disbursements, as well as any outstanding amounts due within the fiscal period. This treatment is consistent with the focus on current financial resources under the modified accrual basis, as these expenditures are expected to be incurred and liquidated within the fiscal period.

In general, the FY2027 Budget includes mainly two categories of reserves: (i) those required by law, the Certified Fiscal Plan, contractual agreements, the Plan of Adjustment (“POA”), or other binding stipulations, such as the Emergency Reserve and the Pension Reserve Trust; and (ii) those established for contingencies or to address unforeseen expenditures, such as the Payroll Reserve, which are not subject to a specific legal or formal stipulation.

Specifically, the Pension Reserve Trust, which represents approximately 85% of the *Appropriations to Non-Governmental Entities* category, constitutes a contribution established under the POA to help prevent shortfalls in future pension-related payments. While this reserve is not fully aligned with the modified accrual basis, as it does not necessarily represent an expenditure expected to be incurred within FY2027, preliminary discussions with the FOMB indicate that it may be treated as an exception to Section 209 of PROMESA, as currently contemplated under the draft guidance under discussion. With respect to the Emergency Reserve, no expenditure is included in the FY2027 Budget, as the full stipulated amount of \$1.3 billion was budgeted in prior fiscal years. Although some of these funds were transferred to municipalities or other government entities to cover emergency needs, it has been determined, due to immateriality, that it is not necessary to replenish these funds. However, monitoring efforts will continue and be strengthened to ensure that such expenditures are properly claimed and reimbursed by the corresponding federal agencies.

Other reserves are not necessarily derived from modified accrual accounting principles, as they do not represent recognized expenditures or liabilities under that basis. Rather, they constitute budgetary mechanisms designed to support fiscal stability, mitigate risks, and preserve the structural balance of the budget. In coordination with the FOMB, their treatment is

currently under evaluation with respect to the application or exclusion from Section 209 of PROMESA and will be addressed in the guidelines currently under development in conjunction with the FOMB Fiscal Transformation Team. Notwithstanding, these reserves are reported in a manner that is fully consistent with the fund-balance classification hierarchy established by GASB Statement No. 54. Also, Section 17 of the General Fund Joint Resolution restricts the Reserve for Budget Stabilization, the Emergency Reserve, the unallocated capital expenditures, the payroll reserve, the Civil Service Reform reserve, the Puerto Rico Electric Power Authority reserve, and other custodial accounts from any disbursement absent the FOMB's prior written approval. These restrictions correspond directly to the *restricted* and *committed* fund-balance classifications under GASB Statement No. 54, with the Risk Reserve established under Section 4 of the General Fund Joint Resolution operating as an *assigned* balance available for specified contingencies during the fiscal year, subject to FOMB approval.

For capital expenditures (CapEx), agencies submit planned projects for FY2027, along with estimates of the related cost expected to be incurred during the fiscal period and anticipated to be liquidated with current available financial resources. These projects and their associated estimates are evaluated as part of the budget formulation process to ensure alignment with programmatic priorities and fiscal constraints.

For the FY2027 Budget, of the \$133 million designated for CapEx, \$123 million is directly allocated to specific projects expected to be completed during the fiscal year, while approximately \$10 million, or less than 1% of the FY2027 Budget, remains unallocated. Because the FY2027 Budget has not yet been submitted to the Legislature for approval and, accordingly, this specific category may be subject to change.

However, due to the nature of capital projects—including procurement processes, development stages, and construction timelines—execution may extend beyond the fiscal year. As a result, in certain cases, budgeted amounts are not fully expended within the current fiscal period, and agencies may request carryforwards or extensions of appropriations. Such requests are not fully aligned with the principles of the modified accrual basis, which emphasize the use of current financial resources within the fiscal period.

For these cases, the OMB, in coordination with the FOMB, is evaluating the appropriate treatment, including both capital and operating expenditure carryforwards or extensions and the utilization of prior-year surpluses. These matters are currently under evaluation with respect to the application to, or exclusion from Section 209 of PROMESA and will be addressed in the guidelines currently under development in conjunction with the FOMB Fiscal Transformation Team.

It is important to note that certain carryforwards or extensions are mandated pursuant to court orders and are included among the exclusions set forth in Section 9 of the FY2027

Budget. Section 9 of the General Fund Joint Resolution further preserves the carryover of “appropriations authorized in the fiscal year to carry out permanent improvements that have been encumbered, accounted for, and kept on the books,” together with the carryover of FY2026 appropriations “that have been encumbered and a liability has been incurred on or before June 30, 2026.” This treatment reflects the use of encumbrance accounting as a budgetary control tool. In addition, Sections 10 and 16 of the General Fund Joint Resolution require the Department of the Treasury, the Fiscal Agency and Financial Advisory Authority (“AAFAF”), and the OMB to certify the amounts of unused FY2026 appropriations and to attest, each quarter, that no prior-year appropriation has been used to cover any current-period expense (other than the carryovers expressly preserved by the Joint Resolution). These certifications operationalize the matching of expenditures to the period in which the underlying obligation requires the use of current financial resources.

To encourage agencies to achieve specific milestones or complete designated projects, incentive payments are included in the FY2027 Budget. These incentives are disbursed only upon verification that the agency has completed the applicable deliverables and complied with all established requirements. Given the assumption that the underlying projects or initiatives will be completed within the fiscal year, these amounts are recognized in the FY2027 Budget as expenditures expected to be incurred and liquidated with current available financial resources.

Consistent with the foregoing, subsidies provided to entities outside the Central Government, such as municipalities, the University of Puerto Rico (UPR) and PREPA, are estimated based on identified funding needs and prior-year utilization patterns, which are budgeted on the basis that they will be fully financed with current available financial resources. Under the *Social well-being for Puerto Rico* category, a material component of the budget, approximately \$51 million has been allocated for subsidies to municipalities and \$501 million for the UPR. This budget category also includes approximately \$1,011 million designated for health insurance payments, as provided under Act No. 72-1993, based on actuarial projections for the fiscal period. While these projections are subject to change, they represent management’s best estimate as of the date of this submission, based on the most current actuarial information available. Collectively, these three budget items represent approximately 76% of the total for the category.

Similarly, within the Social Well-being for Puerto Rico category, certain additional line items totaling approximately \$308 million are budgeted to be transferred to and expensed by other government entities outside the Commonwealth Budget, such as the Puerto Rico Highway and Transportation Authority and municipalities. These funds are received through the Department of the Treasury (“Hacienda”), which serves as the administrative conduit for the allocation and distribution of these amounts upon receipt. In this context, these amounts represent projected cash inflows expected during the fiscal year for allocation purposes and are included in the budget to support cash flow planning and distribution. Although they are not recognized as operating

expenditures of the Commonwealth Budget entities, the funds are distributed to other government entities throughout the fiscal year in accordance with the established allocation process. This presentation may not fully align with modified accrual accounting treatment, given the pass-through nature of these funds; however, it reflects the current budgetary presentation and cash flow planning approach and should be further discussed as part of the guidance currently in process.

With respect to consent decrees and court judgments, these expenditures are generally recognized in the budget at a minimum amount consistent with the stipulations established in the applicable legal agreements or court determinations. Where no specific amount is mandated, amounts are based on prior-year trends. For FY2027, funding for these purposes has been budgeted and allocated across multiple categories, with expenditures expected to be incurred during the fiscal year. This treatment is aligned with modified accrual accounting principles, under which expenditures are recognized when the related liabilities are incurred and are expected to be liquidated with current available financial resources. Cases still in the litigation process or under appeal were not included in the FY2027 Budget. This approach ensures that the Commonwealth's budgetary commitments remain aligned with its legal obligations while preserving fiscal discipline and accountability in the management of public resources.

Under the Plan of Adjustment (POA), *Debt service* obligations are predetermined and therefore fully incorporated into the budget based on existing liabilities, with amounts scheduled in accordance with the applicable payment structure. Accordingly, such debt service payments are reflected in the budget as required expenditures expected to be satisfied with current available financial resources. Although the POA stipulates that certain payments be made using cash balances on the balance sheet accumulated in prior fiscal years, such payments are treated in a consistent manner for budgetary purposes.

Finally, as part of our analysis and to demonstrate that these adjustments do not impact the budgetary process or its underlying estimates, the following categories represent the principal areas affecting the current conversion process to the modified accrual basis for financial statement purposes.

Collectively, these categories reflect the general adjustments required to align actual financial information with the recognition principles under the modified accrual basis. These adjustments generally relate to expenditures incurred during the current fiscal year that were not recorded in the appropriate period but are supported by existing budgetary appropriations for the current fiscal year. Because these adjustments fall within the scope of appropriations already adopted for the current period, they do not require additional budgetary action and may be recorded through the financial statement adjustment process. This process ensures that financial reporting is consistent with applicable governmental accounting standards established by the GASB.

Main Categories Impacting the Current Conversion to Modified Accrual

i. **Adjustments resulting from procedures such as the search for unrecorded liabilities and the review of open invoices are undertaken to ensure the proper recognition of expenditures incurred and the corresponding liabilities as of fiscal year-end.**

- a. These adjustments are necessary because the Puerto Rico Integrated Financial Accounting System (PRIFAS) currently does not include an accounts payable module; accordingly, expenditures are recorded at the time of disbursement rather than when the underlying obligation is incurred. These adjustments generally result from the timing of vendor invoice submission, which may occur near or subsequent to the close of the fiscal year.

Such adjustments do not affect the development of the budget, as the budgeting process is designed to reflect all anticipated disbursements within a fiscal year, including operational expenditures and those arising from contractual and legal commitments, irrespective of the timing of invoice receipt or payment processing. Accordingly, while certain expenditures incurred near year-end may remain recorded as encumbrances due to the timing of invoicing, they are nonetheless contemplated within the approved budget. For financial reporting purposes, an adjusting entry is recorded at fiscal year-end to recognize these expenditures and the related liabilities in the appropriate period under the modified accrual basis of accounting.

ii. **Interfund and component unit adjustments, including reconciliations with audited financial statements and/or validated financial information from each entity, are performed to ensure the proper alignment of financial balances.**

- a. Interfund balances are derived from the audited financial statements of blended component units. Although these entities are legally separate from the GAAP require their inclusion in the Government's financial reporting entity when they are, in substance, indistinguishable from the Government. Accordingly, for financial reporting purposes, their legal separation is eliminated, and their financial information is fully integrated into the Government's reporting structure.

These entities, treated as part of the Government for accounting purposes, engage in transactions with other governmental funds. For example, the Public Buildings Authority (PBA), a blended component unit, leases facilities to governmental instrumentalities, resulting in rental expenditures that are incorporated into budget appropriations based on executed agreements, historical usage, and applicable contractual escalation clauses.

Similarly, discretely presented component units such as the Puerto Rico Electric Power Authority (PREPA) and the Puerto Rico Aqueduct and Sewer Authority (PRASA)

provide services to Government entities, resulting in accounts payable to component units rather than interfund balances.

In both cases, budget appropriations must include sufficient resources to cover expected expenditures for goods and services received during the fiscal year. Adjusting entries are recorded for financial reporting purposes to recognize expenditures incurred but not recorded at year-end, typically due to the timing of invoice receipt, processing delays, unissued invoices, or outstanding encumbrances.

However, these adjustments do not represent additional budgetary requirements, as such expenditures are already contemplated within approved appropriations.

iii. Accrual of Revenues and Recognition of Accounts Receivable:

- a. Adjustments for earned revenues and accounts receivable related to excise taxes, sales and use tax (IVU), individual and corporate income taxes, federal grants, among others.

It is important to note that, to the extent that available budgetary balances are insufficient to cover the amount of an invoice, the related obligation may not be recorded or disbursed until additional budgetary resources are identified within the corresponding appropriations and formally reprogrammed through an authorized reapportionment request, in accordance with PROMESA and Section 12 of the General Fund Budget Resolution.

Furthermore, the Government is currently advancing the implementation of an Enterprise Resource Planning (ERP) system, which is being developed in alignment with modified accrual accounting principles. The go-live of the Finance module is expected on July 1, 2026. In preparation, guidance, procedures, policies, and training programs are under development to ensure that personnel are adequately equipped and that appropriate documentation is available to support a successful implementation. While significant work remains, efforts are actively underway and progressing in the right direction toward achieving standardized, uniform, and timely financial reporting, which, among other benefits, will enhance data consistency, strengthen financial controls, and improve the alignment between accounting, financial reporting, and budgeting processes.

This annex should be read in conjunction with the following documents:

- Government of Puerto Rico Budget Process Manual, and Special Memorandum 012-2025, issued on November 18, 2025, known as the Annual Budget Letter – Fiscal Year 2026-2027;
- Act No. 147 of June 18, 1980, as amended, known as the Management and Budget Office Organic Act;

- Act No. 3-2017, as amended, known as Act to Address the Economic, Fiscal, and Budget Crisis to Guarantee the Operations of the Government of Puerto Rico;
- Act No. 230 of July 23, 1974, as amended, known as the Puerto Rico Government Accounting Act;
- applicable administrative pronouncements issued by the Office of Management and Budget; and
- *Manual de Contabilidad Gubernamental de Puerto Rico*, to be issued by Hacienda. This Manual, currently in draft form, is expected to become effective on July 1, 2026, and is included as part of this submission for reference purposes only and not as a formal submission.

The OMB is currently in the process of updating the Government of Puerto Rico Budget Process Manual for FY2028 to provide additional guidance to Commonwealth entities in the preparation of their budgets, including alignment with the *Manual de Contabilidad Gubernamental de Puerto Rico* once it becomes effective, and to further explain and reinforce alignment with MAAS.

All of the foregoing constitutes an integral component of the budget formulation and monitoring process, as they provide overarching guidance for the application of modified accrual accounting principles across all Commonwealth entities, ensuring uniformity, consistency and transparency in the recognition, measurement and reporting of governmental revenues and expenditures.

In conclusion, this memorandum and the accompanying budget presentation reflect the Government of Puerto Rico's commitment to the consistent application of modified accrual accounting principles, as defined under applicable GASB guidance and PROMESA requirements. The FY2027 Budget has been developed on a statutory budgetary basis for appropriation and control purposes and has been evaluated for consistency with MAAS through the revenue, expenditure, and reconciling-item analysis described herein. The principal revenue estimates were analyzed to determine whether projected amounts are measurable and reasonably expected to be available within the applicable recognition periods, and the principal expenditure categories were evaluated to determine whether they represent obligations expected to be incurred and liquidated with current available financial resources during FY2027. Any budgetary items that do not meet those criteria should be classified, reconciled, or excluded only in accordance with applicable FOMB guidance or concurrence. The FY2027 Budget is structured to support compliance with PROMESA's modified accrual budget requirement and balanced budget framework.
