

**THE CHILDREN'S TRUST**  
(A Component Unit of the Commonwealth of Puerto Rico)  
Basic Financial Statements and  
Required Supplementary Information  
June 30, 2023  
(With Independent Auditors' Report Thereon)

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

BASIC FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION  
JUNE 30, 2023

---

## TABLE OF CONTENTS

|  | <u>Pages</u> |
|--|--------------|
| <b>Independent Auditors' Report</b>  | 1-2          |
| <b>Required Supplementary Information</b>  |              |
| Management's Discussion and Analysis (Unaudited)   | 3-6          |
| <b>Basic Financial Statements:</b>   |              |
| Government-Wide Financial Statements -   |              |
| Statement of Net Deficit   | 7            |
| Statement of Activities  | 8            |
| Fund Financial Statements -  |              |
| Balance Sheet - Governmental Funds   | 9            |
| Reconciliation of Balance Sheet - Governmental Funds to the Statement of Net Deficit   | 10           |
| Statement of Revenues, Expenditures, and Changes in Fund Balances -<br>Governmental Funds  | 11           |
| Reconciliation of the Statement of Revenues, Expenditures, and Changes in<br>Fund Balances - Governmental Funds to the Statement of Activities | 12           |
| Notes to Basic Financial Statements  | 13-25        |



**RSM Puerto Rico**  
PO Box 10528  
San Juan, PR 00922-0528

T 787-751-6164  
F 787-759-7479  
[www.rsm.pr](http://www.rsm.pr)

## INDEPENDENT AUDITORS' REPORT

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

### Opinions

We have audited the basic financial statements of the governmental activities and each major fund of The Children's Trust, a component unit of the Commonwealth of Puerto Rico, as of and for the year ended June 30, 2023, and the related notes to the basic financial statements, which collectively comprise The Children's Trust's basic financial statements as listed in the table of contents.

In our opinion, the accompanying basic financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and each major fund of The Children's Trust, as of June 30, 2023, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### Basis for Opinions

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 Children's 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 opinions.

### Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the basic financial statements in accordance with accounting principles generally accepted in the United States of America, 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 basic financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about The Children's Trust's ability to continue as a going concern for twelve months beyond the financial statement date, including any current 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 basic 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 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 Children's Trust 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 Children's Trust 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

Accounting principles generally accepted in the United States of America 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 auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

San Juan, Puerto Rico  
April 15, 2024.

Stamp No. E570354 was affixed to  
the original of this report.



# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2023

---

This management's discussion and analysis section (MD&A) provides a narrative overview and analysis of the financial activities of The Children's Trust (the Trust) during the fiscal year ended June 30, 2023. The following presentation is by necessity highly summarized, and therefore, in order to gain a thorough understanding of the Trust's financial condition, the basic financial statements, notes, and required supplementary information should be reviewed in their entirety.

### 1. FINANCIAL HIGHLIGHTS

- The Trust's government-wide net deficit for the fiscal year 2023 was approximately \$1.4 billion, a net deficit increase of approximately \$25.3 million, or approximately 1.8%, as compared to fiscal year 2022 (where the net deficit was approximately \$1.37 billion).
- Government-wide revenues for fiscal year 2023 generated from the Global Settlement Agreement, dated November 23, 1998 (the Tobacco Settlement) between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth of Puerto Rico (the Commonwealth) were approximately \$75.3 million, a decrease of approximately \$7.4 million, or approximately 8.9%, as compared to fiscal year 2022 (where revenues generated by the Tobacco Settlement were approximately \$82.7 million).
- Operating expenses consist of payments for programs and activities permitted by the Trust's enabling legislation, Act 173 of July 30, 1999, as amended (Act 173). Total operating expenses were approximately \$105 million, related entirely to the interest expense on the Tobacco Settlement bonds. For fiscal year 2023, there were no outstanding grants agreements or programs.

### 2. OVERVIEW OF THE FINANCIAL STATEMENTS

The financial statements include the MD&A, the independent auditors' report, and the basic financial statements of the Trust. The basic financial statements also include notes that explain in more detail some of the information in the basic financial statements.

### 3. REQUIRED FINANCIAL STATEMENTS

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

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

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2023

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

### 4. FINANCIAL ANALYSIS

The statement of net position (deficit) and the statement of activities report information about the Trust's activities in a way that indicates whether the Trust, as a whole, is better or worse as a result of this year's activities. These two statements report the net deficit of the Trust and the changes in net deficit for the year.

The Trust's net position (deficit)—the difference between assets and the deferred outflows of resources, and liabilities and the deferred inflows of resources—is one way to measure the Trust's financial health or financial position. Over time, increases or decreases in the Trust's net position are one indicator of whether its financial health is improving or deteriorating. However, non-financial factors related to tobacco and general industries and changes in economic conditions and legislation need to be considered as well.

### 5. GOVERNMENT-WIDE FINANCIAL STATEMENTS ANALYSIS

The government-wide financial statements are designed to indicate whether the Trust is in a better or worse financial position when compared to the prior year. The following is a condensed statement of net deficit of the Trust compared with prior year (in thousands):

|                                | As of June 30, |                | Change      |         |
|--------------------------------|----------------|----------------|-------------|---------|
|                                | 2023           | 2022           | Amount      | Percent |
| Assets:                        |                |                |             |         |
| Current assets                 | \$ 10,726      | \$ 10,490      | \$ 236      | 2.2%    |
| Non-current restricted assets  | 142,427        | 143,198        | (771)       | (0.5%)  |
| Total assets                   | 153,153        | 153,688        | (535)       | (0.3%)  |
| Deferred outflows of resources | -              | 815            | (815)       | (100%)  |
| Liabilities:                   |                |                |             |         |
| Current liabilities            | 82             | 122            | (40)        | (32.8%) |
| Non-current liabilities        | 1,551,131      | 1,527,093      | 24,038      | 1.6%    |
| Total liabilities              | 1,551,213      | 1,527,215      | 23,998      | 1.6%    |
| Net deficit                    | \$ (1,398,060) | \$ (1,372,712) | \$ (25,348) | 1.8%    |

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2023

For fiscal year 2023, the Trust's net deficit increased by approximately \$25.3 million, to approximately \$1.4 billion, as compared to fiscal year 2022, due to the following:

- A decrease in total assets of approximately \$535 thousand, related primarily to a decrease in the investments balance due to less amount of money received from the Tobacco Settlement.
- A decrease in deferred outflows of resources of approximately \$815 thousand, due to the amortization of deferred loss on bonds refunding.
- An increase in total liabilities of approximately \$24 million, primarily due to the net effect of interest capitalization for fiscal year 2023 of approximately \$69.7 million on capital appreciation bonds plus an increase in the accretion of the bond discount of \$729 thousand, decreased by the principal payment made amounting to approximately \$46.1 million plus the decrease of the accrued interest payable of approximately \$315 thousand.

Condensed statements of activities are presented below (in thousands):

| Function/Program                           | For the Year Ended June 30, |             | Change     |         |
|--|-----------------------------|-------------|------------|---------|
|  | 2023                        | 2022        | Amount     | Percent |
| Expenses of governmental activities:       |                             |             |            |         |
| Interest on long term debt and Other - net | \$ 105,058                  | \$ 105,019  | \$ 39      | 0%      |
| Total                                      | 105,058                     | 105,019     | 39         | 0%      |
| Revenues of governmental activities:       |                             |             |            |         |
| Investment earnings                        | 4,331                       | 3,435       | 896        | 26.1%   |
| Global Settlement Agreement                | 75,321                      | 82,703      | (7,382)    | (8.9%)  |
| Other income                               | 58                          | -           | 58         | 100%    |
| Total                                      | 79,710                      | 86,138      | (6,428)    | (7.5%)  |
| Change in net deficit                      | \$ (25,348)                 | \$ (18,881) | \$ (6,467) | 34.3%   |

For fiscal year 2023, the Trust had a net deficit increase of approximately \$6.5 million from approximately \$18.9 million in fiscal year 2022 to approximately \$25.3 million in fiscal year 2023. This net deficit increase was due primarily to the decrease in revenues of approximately \$6.4 million. The net decrease in revenues was attributed to an increase in investment earnings and other income of approximately \$954 thousand and a decrease in the annual contribution from the Tobacco Settlement of approximately \$7.4 million. The annual contribution from the Tobacco Settlement depends on the actual shipment of cigarettes each year, which could be affected by factors such as inflation, demographics, cigarette prices, and regulations, among others.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

JUNE 30, 2023

---

### 6. GOVERNMENTAL FUND FINANCIAL STATEMENTS ANALYSIS

The Trust's governmental funds reported fund balances of approximately \$115.8 million as of June 30, 2023, which is approximately \$516 thousand less than the prior fiscal year ending June 30, 2022. The fund balance decrease in governmental funds was mainly due to a decrease in investments and investment contracts amounting to approximately \$535 thousand.

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

|  | As of June 30, |            | Change   |         |
|--|----------------|------------|----------|---------|
|  | 2023           | 2022       | Amount   | Percent |
| Assets   | \$ 153,153     | \$ 153,688 | \$ (535) | (0.3%)  |
| Liabilities and deferred inflows of resource                       | \$ 37,332      | \$ 37,351  | \$ (19)  | (0.1%)  |
| Fund Balance   | 115,821        | 116,337    | (516)    | (0.4%)  |
| Total liabilities, deferred inflows of resources and fund balances | \$ 153,153     | \$ 153,688 | \$ (535) | (0.3%)  |

### 7. DEBT ADMINISTRATION

The Trust has three outstanding Tobacco Settlement bond issuances (each of which is described in Note 7 of the accompanying basic financial statement). During the fiscal year ended June 30, 2023, principal and interest payments on bonds payable amounted to approximately \$46.1 million and \$34.1 million, respectively. As of June 30, 2023, the remaining balance on bonds was approximately \$1.5 billion, net of approximately \$12 million of non-accreted bond discount, due through fiscal year 2057.

### 8. CURRENTLY KNOWN FACTS

On September 26, 2023, the Trust issued a request for proposals ("RFP") to 21 eligible organizations to submit program proposals on or before November 15, 2023. The Trust will then evaluate the proposals and determine, subject to the approval by the Board of Directors of the Trust, which program proposals are eligible for a grant agreement with the Trust.

### 9. REQUEST FOR INFORMATION

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



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

STATEMENT OF NET DEFICIT  
JUNE 30, 2023

|   | <u>Governmental<br/>Activities</u> |
|---|------------------------------------|
| <b>ASSETS</b>                               |                                    |
| <b>CURRENT ASSETS:</b>                      |                                    |
| Cash  | \$ 10,725,985                      |
| Total current assets                        | <u>10,725,985</u>                  |
| <b>NON-CURRENT RESTRICTED ASSETS:</b>       |                                    |
| Investments and investment contracts        | 104,630,170                        |
| Accrued interest receivable                 | 547,510                            |
| Receivable from Global Settlement Agreement | <u>37,249,595</u>                  |
| Total noncurrent restricted assets          | <u>142,427,275</u>                 |
| Total assets                                | <u>153,153,260</u>                 |
| <b>LIABILITIES</b>                          |                                    |
| <b>CURRENT LIABILITIES:</b>                 |                                    |
| Accounts payable                            | <u>81,800</u>                      |
| Total current liabilities                   | <u>81,800</u>                      |
| <b>NON-CURRENT LIABILITIES:</b>             |                                    |
| Liabilities payable from restricted assets- |                                    |
| Accrued interest payable                    | 3,957,031                          |
| Bonds payable                               | <u>1,547,174,265</u>               |
| Total non-current liabilities               | <u>1,551,131,296</u>               |
| Total liabilities                           | <u>1,551,213,096</u>               |
| <b>NET DEFICIT</b>                          |                                    |
| Restricted                                  | 138,470,244                        |
| Unrestricted                                | <u>(1,536,530,080)</u>             |
| Total net deficit                           | <u>\$ (1,398,059,836)</u>          |

See notes to basic financial statements.

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

STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2023

| Functions/Programs                     | Expenses              | Program Revenues    |                         | Net Revenues / (Expenses) and Changes in Net Deficit |
|--|-----------------------|---------------------|-------------------------|--|
|  |                       | Investment Earnings | Operating Contributions |  |
| <b>GOVERNMENTAL ACTIVITIES:</b>        |                       |                     |                         |  |
| Debt service and other                 | \$ 105,058,273        | \$ 4,029,286        | \$ 75,320,927           | \$ (25,708,060)                                      |
| Total governmental activities          | <u>\$ 105,058,273</u> | <u>\$ 4,029,286</u> | <u>\$ 75,320,927</u>    | (25,708,060)   |
| <b>GENERAL REVENUES:</b>               |                       |                     |                         |  |
| Investment earnings                    |                       |                     |                         | 301,713  |
| Other income                           |                       |                     |                         | <u>58,499</u>  |
| <b>CHANGE IN NET DEFICIT</b>           |                       |                     |                         | (25,347,848)   |
| <b>NET DEFICIT - Beginning of year</b> |                       |                     |                         | <u>(1,372,711,988)</u>                               |
| <b>NET DEFICIT - End of year</b>       |                       |                     |                         | <u>\$ (1,398,059,836)</u>                            |

See notes to basic financial statements.

**THE CHILDREN’S TRUST**

(A Component Unit of the Commonwealth of Puerto Rico)

**BALANCE SHEET – GOVERNMENTAL FUNDS**

**JUNE 30, 2023**

|   | <u>General Fund</u>         | <u>Debt<br/>Service Fund</u> | <u>Total<br/>Governmental<br/>Funds</u> |
|---|-----------------------------|------------------------------|---|
| <b>ASSETS</b>   |                             |                              |   |
| Cash  | \$ 10,725,985               | \$ -                         | \$ 10,725,985                           |
| Investment and investment contracts                                     | -                           | 104,630,170                  | 104,630,170                             |
| Accrued interest receivable   | -                           | 547,510                      | 547,510                                 |
| Receivable from Global Settlement Agreement                             | -                           | 37,249,595                   | 37,249,595                              |
|   | <u>                    </u> | <u>                    </u>  | <u>                    </u>             |
| Total assets  | <u>\$ 10,725,985</u>        | <u>\$ 142,427,275</u>        | <u>\$ 153,153,260</u>                   |
| <b>LIABILITIES, DEFERRED INFLOWS OF<br/>RESOURCES AND FUND BALANCES</b> |                             |                              |   |
| <b>LIABILITIES - accounts payable</b>                                   |                             |                              |   |
|   | <u>\$ 81,800</u>            | <u>\$ -</u>                  | <u>\$ 81,800</u>                        |
| <b>DEFERRED INFLOWS OF RESOURCES -</b>                                  |                             |                              |   |
| Unearned revenue  | <u>-</u>                    | <u>37,249,595</u>            | <u>37,249,595</u>                       |
| <b>FUND BALANCES:</b>   |                             |                              |   |
| Restricted  | -                           | 105,177,680                  | 105,177,680                             |
| Unassigned  | <u>10,644,185</u>           | <u>-</u>                     | <u>10,644,185</u>                       |
| Total fund balances   | <u>10,644,185</u>           | <u>105,177,680</u>           | <u>115,821,865</u>                      |
|   | <u>                    </u> | <u>                    </u>  | <u>                    </u>             |
| Total liabilities, deferred inflows of<br>resources and fund balances   | <u>\$ 10,725,985</u>        | <u>\$ 142,427,275</u>        | <u>\$ 153,153,260</u>                   |

See notes to basic financial statements.

**THE CHILDREN'S TRUST**

(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF BALANCE SHEET – GOVERNMENTAL FUNDS TO THE  
STATEMENT OF NET DEFICIT  
JUNE 30, 2023

---

|   |                                  |
|---|----------------------------------|
| <b>FUND BALANCES OF GOVERNMENTAL FUNDS</b>  | \$ 115,821,865                   |
| <b>AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES ARE DIFFERENT IN THE<br/>STATEMENT OF NET DEFICIT BECAUSE:</b>  |                                  |
| Receivable from Global Settlement Agreement to be applied to debt service will not be received in the current period and, therefore, is reported as deferred inflows of resources in the fund financial statements. | 37,249,595                       |
| Accrued interest payable is not due and payable in the current period and, therefore, is not reported in the fund financial statements.   | (3,957,031)                      |
| Bonds payable are not due and payable in the current period and, therefore, are not reported in the fund financial statements.  | <u>(1,547,174,265)</u>           |
| <b>NET DEFICIT OF GOVERNMENTAL ACTIVITIES</b>   | <u><u>\$ (1,398,059,836)</u></u> |

See notes to basic financial statements.

**THE CHILDREN’S TRUST**

(A Component Unit of the Commonwealth of Puerto Rico)

STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND  
BALANCES – GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED JUNE 30, 2023

|  | General Fund         | Debt<br>Service Fund  | Total<br>Governmental<br>Funds |
|--|----------------------|-----------------------|--------------------------------|
| <b>REVENUES:</b>                         |                      |                       |                                |
| Investment earnings                      | \$ 301,713           | \$ 4,029,286          | \$ 4,330,999                   |
| Other income                             | 58,499               | -                     | 58,499                         |
| Revenue from Global Settlement Agreement | -                    | 75,300,571            | 75,300,571                     |
| Total revenues                           | <u>360,212</u>       | <u>79,329,857</u>     | <u>79,690,069</u>              |
| <b>EXPENDITURES:</b>                     |                      |                       |                                |
| Other                                    | 104,580              | -                     | 104,580                        |
| Debt service:                            |                      |                       |                                |
| Principal                                | -                    | 46,050,000            | 46,050,000                     |
| Interest                                 | -                    | 34,051,024            | 34,051,024                     |
| Total expenditures                       | <u>104,580</u>       | <u>80,101,024</u>     | <u>80,205,604</u>              |
| <b>OTHER FINANCING SOURCES/(USES) -</b>  |                      |                       |                                |
| Transfers in/(out)                       | <u>19,931</u>        | <u>(19,931)</u>       | <u>-</u>                       |
| <b>NET CHANGES IN FUND BALANCES</b>      | 275,563              | (791,098)             | (515,535)                      |
| <b>FUND BALANCES - Beginning of year</b> | <u>10,368,622</u>    | <u>105,968,778</u>    | <u>116,337,400</u>             |
| <b>FUND BALANCES - End of year</b>       | <u>\$ 10,644,185</u> | <u>\$ 105,177,680</u> | <u>\$ 115,821,865</u>          |

See notes to basic financial statements.

**THE CHILDREN'S TRUST**

(A Component Unit of the Commonwealth of Puerto Rico)

RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCES - GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2023

---

|   |                        |
|---|------------------------|
| <b>NET CHANGE IN FUND BALANCE - GOVERNMENTAL FUNDS</b>  | \$ (515,535)           |
| <b>AMOUNTS REPORTED FOR GOVERNMENTAL ACTIVITIES ARE DIFFERENT IN THE STATEMENT OF ACTIVITIES BECAUSE:</b>   |                        |
| Net change in receivable from Global Settlement Agreement is reported as revenue in the statement of activities, but is not reported in the fund financial statement since it does not provide current financial resources.   | 20,357                 |
| Net change in interest payable reported in the statement of activities that does not require the use of current financial resources and, therefore, are not reported as an expenditure in the governmental funds.             | 315,304                |
| Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces bonds payable in the statement of net position; this is the amount of redemption on bond principal during the year.        | 46,050,000             |
| Interest capitalization on the 2005 and 2008 Series of the Tobacco Settlement Asset-Backed Bonds do not require the use of current financial resources and, therefore, are not reported as expenditure in governmental funds. | (69,674,261)           |
| The amortization of deferred loss on bonds refunded and the accretion of bonds discount do not require the use of current financial resources and, therefore, are not reported as expenditures in the governmental funds-     |                        |
| Accretion of bond discount  | (728,612)              |
| Amortization of loss on refunding   | (815,101)              |
| <b>CHANGE IN NET DEFICIT OF GOVERNMENTAL ACTIVITIES</b>   | <u>\$ (25,347,848)</u> |

See notes to basic financial statements.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

### 1. REPORTING ENTITY

The Children's Trust (the Trust) is a component unit of the Commonwealth of Puerto Rico (the Commonwealth) created by Act 173 of the Legislature of the Commonwealth on July 30, 1999, and an affiliate of the Government Development Bank of Puerto Rico (GDB), a component unit of the Commonwealth. The Trust was created for the purpose of developing programs aimed at promoting a better quality of life and the well-being of families, children, and youth in Puerto Rico, especially in the areas of education, recreation and health. These programs are financed with funds received by the Commonwealth from the Tobacco Settlement. Pursuant to Act 173, the Commonwealth assigned and transferred to the Trust the contributions that the Commonwealth is entitled to receive under the Tobacco Settlement. The Tobacco Settlement provides for annual payments through the year 2057, which will vary due to inflationary and volume adjustments. After 2057, the tobacco companies shall continue making contributions in perpetuity. Currently, all of the proceeds received from the Tobacco Settlement are pledged to cover the debt service requirements under three outstanding bond issuances of the Trust.

Act 173 also provides that GDB will act as the trustee of the Trust. However, GDB's prior functions are now carried out by the Puerto Rico Fiscal Agency and Financial Advisory Authority (AAFAF), as the new fiscal agent and financial advisor to the Commonwealth pursuant to Act 2 of January 18, 2017, as amended. Pursuant to Act 173, the Trust is exempt from taxation in Puerto Rico.

### 2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of the Trust conform to U.S. Generally Accepted Accounting Principles (GAAP), as applicable to governmental entities. The Trust follows Governmental Accounting Standards Board (GASB) statements under the hierarchy established by Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, in the preparation of its basic financial statements.

The preparation of 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 and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses/expenditures during the reported period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the account receivable from global settlement agreement and the related deferred inflows of resources.

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

#### **Government-Wide and Fund Financial Statements**

*Government-Wide Financial Statements* - The statement of net position (deficit) and the statement of activities report information on all balances and activities of the Trust. The effect of interfund balances has been removed from both statements. Governmental activities are financed through revenues from the Tobacco Settlement, intergovernmental revenues, and investment earnings.

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

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

Net position (deficit) is reported in three categories:

- *Net investment in capital assets* - consists of capital assets, net of accumulated depreciation and amortization and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets, if any. The Trust has no investment in capital assets.
- *Restricted* - results when constraints placed on net position use are either externally imposed by *creditors*, contributors, and the like, or imposed by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, it is the Trust's policy to use restricted resources first and the unrestricted resources when they are needed.
- *Unrestricted* - consists of net position (deficit) that does not meet the definition of the two preceding categories. Unrestricted net position often is designated to indicate that management does not *consider* it to be available for general operations. Unrestricted net position often has constraints on resources, which are imposed by management, but can be removed or modified.

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

*Fund's Financial Statements* - Fund accounting is designed to demonstrate legal compliance and to aid financial management by segregating transactions related to certain government functions or activities. A fund is a separate accounting entity with a self-balancing set of accounts. All of the financial activities of the Trust are reported in the accompanying basic financial statements and have been classified as governmental. All funds of the Trust are major funds.

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

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

### Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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



# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

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

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

- *General Fund* - The general fund is used to account for grants awarded to promote a better quality of life and the well-being of families, children, and youth in Puerto Rico. During the fiscal year ended June 30, 2023, no grants were awarded for health and other purposes.
- *Debt Service Fund* - This debt service fund is used to account for proceeds from the Tobacco Settlement and for the payment of interest and principal on long-term obligations.

*Budgetary Accounting* - Act 173 does not require that the Trust submit a budget for approval by the Legislature of the Commonwealth; consequently, no formal budgetary accounting procedures are followed.

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

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

GASB Statement No. 72, *Fair Value Measurement and Application*, 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 take into account 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. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

- Level 1 Investments whose values are based on quoted prices (unadjusted) for identical assets or liabilities in active markets that a government can access at the measurement date.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

- Level 2 Investments with inputs other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.
- Level 3 Investments have unobservable inputs for an asset or liability and may require a degree of professional judgment.

Realized gains and losses from the sale of investments and unrealized changes in fair values are recorded as investment income.

*Long-term debt, bond issue costs and bond discounts* - The liabilities reported in the government-wide financial statements are bonds payable. Bonds payable are reported net of the applicable bond premium or discount. In the government-wide financial statements and the governmental funds financial statements, the bond issue costs are recorded as expenditures when paid. Discount on bonds is accreted over the life of the debt using the effective interest method in the government-wide financial statements. Discount on bonds is accounted for in the governmental funds as expenditures when paid.

*Deferred Outflows/Inflows of Resources* - In addition to assets, the statement of net position (deficit) will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position (deficit) that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The Trust has one major caption that qualifies for reporting in this category: the unamortized balance of loss on bonds defeasance, reported in the government-wide statement of net position (deficit). A loss on bond defeasance, or refunding, results from the difference in the carrying value of a refunded debt and its reacquisition price. This amount is capitalized and amortized over the shorter of the life of the refunded or refunding debt as a component of interest expense in the government-wide statement of activities. Further information about the balance of unamortized deferred refunding losses is discussed in Note 7.

In addition to liabilities, the statement of net position (deficit) and the governmental funds' balance sheet will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position (deficit) and resources that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until that time. The Trust has only one caption that qualifies for reporting in this category, and that is unearned revenue from the Tobacco Settlement, reported in the governmental fund balance sheet. Deferred inflows of resources at the governmental fund level arise when potential revenue does not meet the "available" criteria for revenue recognition in the current period under the accrual basis of accounting. In subsequent periods, when the revenue recognition criteria is met, or when the applicable resources become available, the deferred inflow of resources is removed from the balance sheet, and the revenue is recognized. Further information about the balance of unearned revenue is discussed below and in Note 8.

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

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

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

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

*Interfund transfers* - Legally required transfers are reported when incurred as transfer in by the recipient fund and as transfer out by the disbursing fund, with receivables and payables presented as amounts due to and due from other funds. Advances between funds are also presented as amounts due to and due from other funds. However, these advances, transfers, and related amounts receivable and payable are considered internal balances and activities that have been eliminated in the government-wide financial statements.

*Risk Management* - To minimize the risk of loss, the Trust is covered by AAFAF's insurance coverage for public liability, hazard, automobile, crime, and bonding.

*Recently Issued Accounting Guidance* - GASB has issued the following accounting pronouncements that have an effective date after June 30, 2023:

- (a) **GASB Statement No. 99, Omnibus 2022.** The objectives of this Statement are to enhance comparability in accounting and financial reporting and to improve the consistency of authoritative literature by addressing (1) practice issues that have been identified during implementation and application of certain GASB Statements and (2) accounting and financial reporting for financial guarantees.

The requirements of this Statement are effective as follows:

- The requirements related to extension of the use of LIBOR, accounting for SNAP distributions, disclosures of nonmonetary transactions, pledges of future revenues by pledging governments, clarification of certain provisions in Statement 34, as amended, and terminology updates related to Statement 53 and Statement 63 are effective upon issuance.
- The requirements related to leases, PPPs, and SBITAs are effective for fiscal years beginning after June 15, 2022, and all reporting periods thereafter.
- The requirements related to financial guarantees and the classification and reporting of derivative instruments within the scope of Statement 53 are effective for fiscal years beginning after June 15, 2023, and all reporting periods thereafter.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

- (b) **GASB Statement No. 100, *Accounting Changes and Error Corrections***. The primary 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 defines accounting changes as changes in accounting principles, changes in accounting estimates, changes to or within the financial reporting entity, and describes the transactions or other events that constitute those changes. As part of those descriptions, for (1) certain changes in accounting principles and (2) certain changes in accounting estimates that result from a change in measurement methodology, a new principle or methodology should be justified on the basis that it is preferable to the principle or methodology used before the change.

That preference should be based on the qualitative characteristics of financial reporting understandability, reliability, relevance, timeliness, consistency, and comparability. This Statement also addresses corrections of errors in previously issued financial statements.

This Statement prescribes the accounting and financial reporting for (1) each type of accounting change and (2) error corrections. This Statement requires that (a) changes in accounting principles and error corrections be reported retroactively by restating prior periods, (b) changes to or within the financial reporting entity be reported by adjusting beginning balances of the current period, and (c) changes in accounting estimates be reported prospectively by recognizing the change in the current period.

The requirements of this Statement for changes in accounting principles apply to the implementation of a new pronouncement in the absence of specific transition provisions in the new pronouncement. This Statement also requires that the aggregate amount of adjustments to and restatements of beginning net position, fund balance, or fund net position, as applicable, be displayed by reporting unit in the financial statements. 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 that 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.

The requirements of this Statement are effective for accounting changes and error corrections made in fiscal years beginning after June 15, 2023, and all reporting periods thereafter. Earlier application is encouraged.

- (c) **GASB Statement No. 101, *Compensated Absences***. The primary 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. 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.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

That objective is achieved by aligning the recognition and measurement guidance under a unified model and by amending certain previously required disclosures. This Statement also establishes guidance for measuring a liability for leave that has not been used, generally using an employee's pay rate as of the date of the financial statements. A liability for leave that has been used but not yet paid or settled should be measured at the amount of the cash payment or noncash settlement to be made. Certain salary-related payments that are directly and incrementally associated with payments for leave also should be included in the measurement of the liabilities.

With respect to financial statements prepared using the current financial resources measurement focus, this Statement requires that expenditures be recognized for the amount that normally would be liquidated with expendable available financial resources. This Statement requires that a liability for certain types of compensated absences—including parental leave, military leave, and jury duty leave—not be recognized until the leave commences. This Statement also requires that a liability for specific types of compensated absences not be recognized until the leave is used.

The requirements of this Statement are effective for fiscal years beginning after December 15, 2023 (FY 2024-2025), and all reporting periods thereafter. Earlier application is encouraged.

### (d) GASB Statement No. 102, *Certain Risk Disclosures*

State and local governments face a variety of risks that could negatively affect the level of service they provide or their ability to meet obligations as they come due. Although governments are required to disclose information about their exposure to some of those risks, essential information about other risks that are prevalent among state and local governments is not routinely disclosed because it is not explicitly required. 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.

This Statement defines a concentration as a lack of diversity related to an aspect of a significant inflow of resources or outflow of resources. A constraint is a limitation imposed on a government by an external party or by formal action of the government's highest level of decision-making authority. Concentrations and constraints may limit a government's ability to acquire resources or control spending.

This Statement requires a government to assess whether a concentration or constraint makes the primary government reporting unit or other reporting units that report a liability for revenue debt vulnerable to the risk of a substantial impact. Additionally, this Statement requires a government to assess whether an event or events associated with a concentration or constraint that could cause the substantial impact have occurred, have begun to occur, or are more likely than not to begin to occur within 12 months of the date the financial statements are issued. If a government determines that those criteria for disclosure have been met for a concentration or constraint, it should disclose information in notes to financial statements in sufficient detail to enable users of financial statements to understand the nature of the circumstances disclosed and the government's vulnerability to the risk of a substantial impact. The disclosure should include descriptions of the following:

- The concentration or constraint
- Each event associated with the concentration or constraint that could cause a substantial impact if the event had occurred or had begun to occur prior to the issuance of the financial statements.
- Actions taken by the government prior to the issuance of the financial statements to mitigate the risk.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

The requirements of this Statement are effective for fiscal years beginning after June 15, 2024, and all reporting periods thereafter. Earlier application is encouraged.

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

### 3. DEPOSITS PLACED WITH BANK

Custodial credit risk is the risk that in the event of a financial institution's failure, the Trust's deposits may not be returned to it. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized for the amount deposited in excess of federal depository insurance.

As of June 30, 2023, none of the depository Trust balance is uninsured or uncollateralized, as indicated in the following table:

|                 | <u>Carrying Amount</u> | <u>Bank Balance</u>  | <u>Amount<br/>uninsured and<br/>uncollateralized</u> |
|-----------------|------------------------|----------------------|--|
| Commercial bank | <u>\$ 10,725,985</u>   | <u>\$ 10,725,985</u> | <u>\$ -</u>  |

### 4. CLAIM RECEIVABLE FROM THE PUBLIC ENTITY TRUST

On November 29, 2018, GDB completed a restructuring of certain of its indebtedness pursuant to a Qualifying Modification under Title VI of PROMESA (the Qualifying Modification). Under the Qualifying Modification, holders of certain bond and deposit claims against GDB exchanged their claims for bonds issued by a newly created public instrumentality - the GDB Debt Recovery Authority (the GDB DRA) - and GDB transferred to such entity its municipal loan portfolio, a portion of its public entity loan portfolio, its real estate owned assets and its unencumbered cash. In addition, pursuant to the GDB Restructuring Act, claims on account of deposits held by the Commonwealth and other public entities were exchanged for interest in a newly formed trust titled the Public Entity Trust (the PET), created pursuant to Act 109-2017, also known as the Government Development Bank for Puerto Rico Debt Restructuring Act (the GDB Restructuring Act).

Under the GDB Restructuring Act, the balance of liabilities owed between the Commonwealth and its agents, instrumentalities and affiliates (each a Non-Municipal Government Entity) and GDB were determined by applying the outstanding balance of any deposits held at GDB in a Non-Municipal Government Entity's name against the outstanding balance of any loan of such Non-Municipal Government Entity owed to GDB or of any bond or note of such Non-Municipal Government Entity held by GDB as of such date. Those Non-Municipal Government Entities having net claims against GDB, after giving effect to the foregoing adjustment received their pro rata share of interests in the PET, which was deemed to be full satisfaction of any and all claims such Non-Municipal Government Entity may have against GDB. As a result of the execution of the Qualifying Modification, the Trust received beneficial units of the PET amounting to \$16.6 million in exchange for the deposits held at GDB.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

---

The assets of the PET (the PET Assets) consist of, among other items, an unsecured claim of \$578 million against the Commonwealth, which is the subject of a proof of claim filed in the Commonwealth's Title III case (the PET Claim). Non-Municipal Government Entities' recoveries on account of their interests in the PET will depend upon the recovery ultimately received by the PET on account of the PET Assets. The Commonwealth Plan of Adjustment discharges any claim related to budgetary appropriations, including appropriations for the repayment of certain loans held by the PET. As of the date hereof, the Court has not determined if the PET Claim is an allowed claim that will be entitled to a distribution. As a result, units received from the PET were accounted for with a carrying value of zero.

### 5. INVESTMENTS AND INVESTMENT CONTRACTS

The Trust follows the investment guidelines promulgated by GDB under Act 113 of August 3, 1995, and Executive Order 1995-50A, which detail the categories for which the Trust may purchase or enter into investments, and establish limitations and other guidelines on maturities and amounts to be invested in the aforementioned investment categories and by issuer/counterparty and on exposure by country.

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

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

As of June 30, 2023, the Trust maintains approximately \$104.6 million in investments and investment contracts, which are held as debt service reserves in trust accounts with US Bank (the trustee) that are governed by the applicable bond indenture. All of the funds used for debt service are held by the trustee in the name of the Trust with the exception of \$83.7 million of non-participating investment contracts.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

As of June 30, 2023, the Trust had the following recurring fair value measurements:

| Investment type   | Level 1       | Level 2 | Level 3       | Total          |
|---|---------------|---------|---------------|----------------|
| External Investment pools- fixed income securities:                                     |               |         |               |                |
| First American Money Market Fund  | \$ 20,945,935 | \$ -    | \$ -          | \$ 20,945,935  |
| Nonparticipating investment contracts- UniCredit Bank AG-Guaranteed Investment Contract | -             | -       | 83,684,235    | 83,684,235     |
|   | \$ 20,945,935 | \$ -    | \$ 83,684,235 | \$ 104,630,170 |

The following table summarizes the type and maturities of investments at fair value held by the Trust as of June 30, 2023. Based on concentration credit risk, investments by type in any one issuer representing 5% or more of total investments have been separately disclosed.

| Investment type   | Within One year | Within to Five Years | Within to Ten Years | After Ten Years | Total          |
|---|-----------------|----------------------|---------------------|-----------------|----------------|
| External investment pools - fixed income securities:                                    |                 |                      |                     |                 |                |
| First American Money Market Fund  | \$ 20,945,935   | \$ -                 | \$ -                | \$ -            | \$ 20,945,935  |
| Nonparticipating investment contracts- UniCredit Bank AG-Guaranteed Investment Contract | -               | -                    | -                   | 83,684,235      | 83,684,235     |
|   | \$ 20,945,935   | \$ -                 | \$ -                | \$ 83,684,235   | \$ 104,630,170 |

The credit quality ratings for investments and investments contracts as of June 30, 2023, are as follows:

| Counter Party     | Credit Risk Rating |         |
|-------------------|--------------------|---------|
|                   | Standard & Poor's  | Moody's |
| First American    | AAAm               | Aaa-mf  |
| UniCredit Bank AG | BBB+               | A2      |

## 6. SERVICE AGREEMENT

On June 30, 2023, the Trust entered into an agreement with AAFAP whereby AAFAP provides managerial, administrative, and financial supporting services to the Trust. Pursuant to this agreement, the Trust was invoiced \$55,900 during the year ended June 30, 2023. Such amount is included as due to AAFAP in accounts payable in the statement of net deficit as of June 30, 2023.



# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

### 7. BONDS PAYABLE

On October 10, 2002, the Trust refunded its then outstanding \$390,170,000 Tobacco Settlement Asset Backed Bonds, Series 2000 dated as of October 1, 2000, with new 2002 Series bonds (the Series 2002 Bonds) in the amount of \$1,171,200,000. As of June 30, 2023, the outstanding balance of these bonds consists of single rated term bonds (the Term Bonds) maturing from May 15, 2034 to 2039 (\$272,580,000 at 5.5%) and from May 15, 2040 to 2043 (\$296,255,000 at 5.625%).

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

On June 30, 2005, the Trust issued a new series of Tobacco Settlement Asset-Backed Bonds, Series 2005A and 2005B (the Series 2005A and Series 2005B Bonds) for \$108,209,446. The Series 2005A and Series 2005B Bonds consist of capital appreciation bonds maturing on May 15, 2026 (\$74,523,431 at 6.50% plus accreted interest) and capital appreciation bonds maturing on May 15, 2028 (\$33,686,016 at 7.25% plus accreted interest), respectively. As of June 30, 2023, the outstanding balances of Series 2005A and Series 2005B Bonds consist of \$235,709,387 and \$121,401,806, respectively.

On April 30, 2008, the Trust issued a new series of Tobacco Settlement Asset-Backed Bonds, Series 2008A and 2008B (the Series 2008A and Series 2008B Bonds) for \$195,878,970. The Series 2008A and Series 2008B Bonds consist of capital appreciation bonds maturing on May 15, 2057 (\$139,003,082 at 7.625% plus accreted interest), and capital appreciation bonds maturing on May 15, 2057 (\$56,875,888 at 8.375% plus accreted interest), respectively. As of June 30, 2023, the outstanding balances of the Series 2008A and 2008B Bonds consist of \$432,447,973 and \$197,404,476, respectively.

The Series 2008A and Series 2008B Bonds are subordinated and are not entitled to receive any payments until the date when the Series 2005A and Series 2005B Bonds are no longer outstanding. The Series 2005A and Series 2005B Bonds are subordinated and are not entitled to receive any payments until the date when the Series 2002 Bonds are no longer outstanding. In addition, the Series 2008B and Series 2005B Bonds are subordinated to the Series 2008A and Series 2005A Bonds, respectively, and are not entitled to receive any payments until the date when the Series 2008A or 2005A Bonds are no longer outstanding. All bonds are secured by 100% of the annual payments received under the Tobacco Settlement. As of June 30, 2023, principal and interest payments on all of the Trust's outstanding bonds are current.

Changes in bonds payable for the year ended June 30, 2023, are summarized as follows (in thousands):

|                     | Balance at<br>July 1,<br>2022 | Additions   | Debt<br>Paid       | Other<br>Increases | Balance at<br>June 30,<br>2023 | Due<br>Within<br>One Year |
|---------------------|-------------------------------|-------------|--------------------|--------------------|--------------------------------|---------------------------|
| Bonds payable       | \$ 1,535,554                  | \$ -        | \$ (46,050)        | \$ 69,674          | \$ 1,559,178                   | \$ -                      |
| Less:               |                               |             |                    |                    |                                |                           |
| Unaccreted discount | (12,733)                      | -           | -                  | 729                | (12,004)                       | -                         |
| Bonds payable       | <u>\$ 1,522,821</u>           | <u>\$ -</u> | <u>\$ (46,050)</u> | <u>\$ 70,403</u>   | <u>\$ 1,547,174</u>            | <u>\$ -</u>               |

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

Changes in deferred outflows of resources during the year ended June 30, 2023, are summarized as follows (in thousands):

| Description                | Balance at<br>July 1, 2022 | Accretion | Balance at<br>June 30, 2023 |
|----------------------------|----------------------------|-----------|-----------------------------|
| Deferred loss on refunding | \$ (815)                   | \$ 815    | \$ -                        |

As of June 30, 2023, debt service requirements for bonds outstanding were as follows (in thousands):

| Year Ending June 30, | Principal           | Interest          | Total               |
|----------------------|---------------------|-------------------|---------------------|
| 2024                 | \$ -                | \$ 34,179         | \$ 34,179           |
| 2025                 | -                   | 34,179            | 34,179              |
| 2026                 | -                   | 34,179            | 34,179              |
| 2027                 | -                   | 34,179            | 34,179              |
| 2028                 | -                   | 34,179            | 34,179              |
| 2029-2033            | -                   | 170,893           | 170,893             |
| 2034-2038            | 210,700             | 168,676           | 379,376             |
| 2039-2043            | 358,135             | 100,393           | 458,528             |
| 2044-2048            | -                   | -                 | -                   |
| 2049-2053            | -                   | -                 | -                   |
| 2054-2057            | <u>8,634,580</u>    | <u>-</u>          | <u>8,634,580</u>    |
|                      | 9,203,415           | <u>\$ 610,857</u> | <u>\$ 9,814,272</u> |
| Less:                |                     |                   |                     |
| Unaccreted discount  | (12,004)            |                   |                     |
| Unaccreted interest  | <u>(7,644,237)</u>  |                   |                     |
| Total Bonds payable  | <u>\$ 1,547,174</u> |                   |                     |

### 8. THE TOBACCO SETTLEMENT

On November 23, 1998, the Tobacco Settlement was entered into by and between certain tobacco companies and certain states, territories, and other jurisdictions of the United States of America, including the Commonwealth. The Tobacco Settlement calls for annual payments through the year 2057, which will vary due to inflationary and volume adjustments. After 2057, the tobacco companies shall continue making contributions in perpetuity on the terms set forth therein.

# THE CHILDREN'S TRUST

(A Component Unit of the Commonwealth of Puerto Rico)

## NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2023

The following is a summary of the projections of annual payments to be received by the Trust in each year through 2057 (unaudited, in thousands):

| Year Ending June 30, | Amount              |
|----------------------|---------------------|
| 2024                 | \$ 74,658           |
| 2025                 | 73,995              |
| 2026                 | 73,332              |
| 2027                 | 72,669              |
| 2028                 | 72,006              |
| 2029-2057            | <u>1,799,754</u>    |
|                      | <u>\$ 2,166,414</u> |

Actual collections from the Tobacco Settlement will fluctuate each fiscal year due to changes in future cigarette consumption, which could be affected by factors such as inflation, demographics, cigarette prices, disposable income, employment, advertising expenditures, and regulations, among others. During 2023, actual collections were \$75,300,571 or 27% less than the projected amount in the master settlement agreement for the year 2023.

All of the revenue received under the Tobacco Settlement and investment earnings on certain accounts under the bond indentures are pledged as collateral for all bond issuances. Net cash proceeds obtained under the bond issuances were used to finance the Trust's programs aimed at promoting a better quality of life and the well-being of families, children, and youth in Puerto Rico, especially through grants extended in the areas of education, recreation, and health. Part of the proceeds from the Series 2008A and Series 2008B Bonds were used to pay certain operating expenses of the Commonwealth. During the year ended June 30, 2023, pledged revenues amounted to \$75,320,927, which were used to pay for \$80,101,024 of related principal and interest of the bond issuances.

### 9. SUBSEQUENT EVENTS

Management has evaluated subsequent events through April 15, 2024, the date the financial statements were available to be issued, to determine if any such events should either be recognized or disclosed in the June 30, 2023 financial statements.