Kevane mailbag

June 30, 2016 – Issue 63

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Our Kevane mailbag is your link to all our communications related to the operations of businesses in Puerto Rico. Our purpose is to offer you up-to-date information concerning tax, accounting and any other matters that might have an impact on the way you conduct business in Puerto Rico.

The Alerts contained in our mailbags can also be accessed through our website under the Publications tab\Professional Articles section or by downloading our business and tax application for mobile, tablets and iPad for free through the App Store and Google Play. We welcome your feedback at kgt@pr.gt.com

Navigate with us…experience the difference!

Audit

The Financial Accounting Standards Board has released an update to simply the equity method released.

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Tax

To ensure the moral character of the grantees under Act 22, additional technical amendments are under way.

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Advisory

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Outsourcing

In Puerto Rico employers have the duty to insure his/her employees against injuries, illnesses or death.

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General Information

Please note that our offices will close at 12 noon on July 22, 2016 and that on July 25 we observe the celebration of the Constitution of the Commonwealth of Puerto Rico.

Audit Alert: ASU simplifying the equity method released

On March 15, the FASB issued ASU 2016-07, *Simplifying the Transition to the Equity Method of Accounting*. The new guidance eliminates the requirement to retroactively adopt the equity method of accounting if an investment previously accounted for using another method subsequently qualifies for accounting under the equity method as a result of an increased level of ownership interest or degree of influence. Instead, an entity should add the cost of acquiring the additional interest in the investee, if any, to the current basis of the investor's previously held interest and adopt the equity method of accounting as of the date the investment qualifies for the equity method.

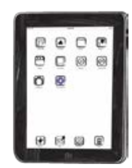
The new guidance also requires entities to recognize in earnings unrealized holding gains or losses previously recognized in accumulated other comprehensive income related to available-for-sale equity securities that become eligible for the equity method at the date the investment qualifies for the equity method.

The new guidance is effective for all entities in fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Entities should prospectively apply the new guidance after its effective date to increases in the level of ownership interest or degree of influence that result in the adoption of the equity method. Early adoption is permitted for all entities.

Source: Grant Thornton, *On The Horizon*, March 24, 2016

We are committed to keep you updated of all developments that may affect the way you do business in Puerto Rico. Please contact us should if we can be of further assistance in relation to this or any other matter.

Contact us
For assistance in this matter, please contact us via luiscarlos.marcano@pr.gt.com



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Tax Alert: Additional technical amendments proposed to Act 22

House of Representatives Bill 2610 ("Bill 2610") proposes new eligibility requirements for the issuance of tax exemption decree ("decree") under Act 22-2012. It also strengthens the public policy of the Government of Puerto Rico to ensure the moral character of the grantees. Currently, this bill is under the consideration of the Conference Committee of the Puerto Rico Legislature.

One of the main differences of the bill approved by the House and the one approved by the Senate, is that the original bill provided for an additional tax of 5% on the capital gain of assets acquired prior to becoming a PR resident. Such tax would apply if the asset is sold after 10 years of becoming a PR resident. The bill approved by the Senate eliminates this tax.

Secretary of Economic Development and Commerce ("Secretary") authority to request information

Once a decree application is filed, the Secretary will have the discretion and powers to accept, deny, or modify the recommendation provided by the Office of Industrial Tax Exemption. Also, the Secretary could request additional information and/or documents.

Additional eligibility requirements

As essential conditions for the issuance of the decree, the applicants must provide the following information:

- last five years' original criminal records issued by any country in which the applicant has lived and/or worked
- sworn statement to prove that no fraud accusation or investigation has been conducted against the applicant
- reliable information regarding the interests and dividends sources
- information to determine if the applicant currently is or has ever been a party to any investigation, administrative proceedings or procedures related to the practice of their profession
- economic information to prove financial solvency.

Revocation powers of the Secretary

In addition, the Secretary will have the authority to revoke any decree when the grantee has incurred in fraud, dishonesty or moral depravity acts.

Note: A grantee adversely affected by a decision issued by the Secretary to revoke and/or cancel a decree will have available the judicial revision procedures, as provided by the laws of Puerto Rico.

We will monitor the development of this tax bill and keep you updated through our Tax Alerts.

Please contact our Tax Department should you require additional information regarding this or any other tax issue. We will be glad to assist you.

Contact us
For assistance in this matter, please contact us via
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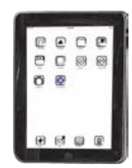

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Advisory Alert: Turnaround "apps" for the public sector - the Finance platform

Introduction

This is the fourth of a series of articles covering our strategic framework for executing turnarounds in the public sector. Our framework is based on 4 turnaround platforms or "apps" that cover the following key areas:

- Strategy
- Operations
- Finance
- Leadership

Our last article covered the **Operations** app. On this piece, we will be focusing on the **Finance** platform.

The finance platform

Today, governmental organizations are suffering from two types of financial distress that are common among private sector enterprises: expenses greater than revenues and excessive future commitments.

A structural imbalance between revenues and expenditures in the general fund is the government equivalent of unprofitable operations in the private sector. As elected officials became euphoric over the increase in revenue in good economic times, they undertook an expansion of services along with generous increases in compensation and benefits for employees. Providing more parks and summer programs for children, building beautiful performing arts centers, adding police and firefighters, and refurbishing government offices are all worthy expenditures when cash is available. So is saving for a rainy day and paying off debt. The latter received short shrift in many instrumentalities in past years, so that when economic disaster hit, there was no cushion. Even those instrumentalities that had the foresight and discipline to save did not expect the impact of the current recession to last as long as it has. Now the government is faced with a cost base that exceeds its revenue potential at least in the near and medium terms.

Many governmental instrumentalities have statutory requirements for a balanced budget, which should prohibit the behavior outlined above. But the requirements are generally not well defined, and as a result, certain instrumentalities have found ways to fund current operating losses with long-term debt.

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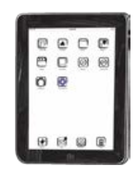

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In short, when there is little motivation to balance operating revenues and expenses, and capital markets encourage borrowing, public officials may postpone or avoid making difficult decisions.

Finance app #1:
Long-term financial planning

Distressed businesses often lack long-term financial plans. The discipline to look three to five years into the future forces management to incorporate strategic plans and create goals that serve the interests of their shareholders. Government is no different.

The US Government Finance Officers Association wrote about building a financially resilient government through long-term financial planning and referenced Jamais Cascio, a senior fellow at the Institute for Ethics and Emerging Technologies, who identifies the following eight essential characteristics of any resilient system:

- diversity – Avoid a single point of failure or reliance on a single solution
- redundancy – Have more than one path of escape
- decentralization – Centralized systems look strong until they fail catastrophically
- transparency – Share plans and preparations, and listen when flaws are pointed out
- collaboration – Work together to become stronger
- falling gracefully – Failure happens
- flexibility – Be ready to change when plans fail; do not count on stability
- Foresight – Think and prepare

This approach is a tool that instrumentalities can use as they undertake strategic planning in concert with long-term financial planning. The following characteristics are particularly resonant when looking at public sector turnaround activities.

Transparency – A challenge with public finance is the lack of transparency and readily understandable financial reporting. Even sophisticated readers of financial information struggle to make heads or tails out of the reports generated by our government units. The timeliness of the information is often lacking —some reports appear many months after the actual results. Prospective financial information is even more challenging than the historical. Governments should institute clear and consistent information based on generally accepted accounting principles.

Foresight – The very concept of long-term planning begs government leaders to think beyond the election cycle and anticipate economic challenges and crises. Developing contingency plans and establishing real, tangible cash reserves are important.

Finance app #2:
Cash flow planning

Jim Gentry, professor emeritus of finance at the University of Illinois at Urbana-Champaign, once said that liquidity is like beer at a fraternity party: when you are out of liquidity, the party is over.

Understanding liquidity in the context of government operations is important to ensuring that essential activities can occur without interruption. Some government units make an attempt at cash flow forecasting, but limit its use to evaluating the need for short-term borrowing – revenue and tax anticipation notes in particular. However, the private sector uses cash forecasts as a "dashboard" to monitor performance, even if the business is not distressed, via a tool called the "13-week rolling cash forecast".

Successful businesses evaluate their forecasts against actual results to understand whether variances were based on timing or permanent differences. This discipline of evaluation creates a continuous feedback loop that enhances management's ability to forecast and minimize variance. How can this be applied in the public sector?

For most governments, 13 weeks is an insufficient time frame. Biannual tax payments, large lag periods associated with federal or state funding, and union contracts with annual lump-sum payments require a longer forecasting horizon. Ideally, a rolling 12-month forecast is better. Governments need to develop a heightened sense of importance around working capital management. In the private sector, businesses have long known that it is important to balance accounts receivable collections with accounts payable expenditures. Ideally, businesses want to collect their receivables as quickly as possible and pay their bills at the latest date acceptable.

Many public sector organizations existed for years without ever having to worry about having enough cash in the bank account to pay bills. This scenario has changed as cities and states have begun to spend more than they take in, making cash flow forecasting more important. Neglecting working capital management exacerbates cash flow problems and diminishes the fun at the party.

In our next article we will talk about turnaround "apps" for governments in the **Leadership platform**.

Call us to make an appointment with one of our experienced advisors. We will be glad to assist you.

Outsourcing Alert: State Insurance Fund policy

It is the duty of every employer to insure his or her employees against all work-related injuries, illnesses or death. The State Insurance Fund Corporation's (CFSE by its acronym in Spanish) Worker's Insurance is the exclusive remedy available to employees in these cases.

Annual payroll statement- next due date

The Annual Payroll Statement (Form FSE 693) must be filed with the CFSE on or before July 20, 2016. The same must show the number of employees, occupation or industry classification and the respective total amount of wages paid during the immediately preceding fiscal year ended June 30.

Employers should be receiving the Annual Payroll Statement by mail during this month. Also, the statement can be completed and filed through the CFSE internet portal.

Online Services

All employers insured under the State Insurance Fund Corporation (CFSE) may request and obtain a Certificate of Good Standing through the CFSE internet portal. This is an official document certifying that the employer complies with all applicable requirements to be insured by the CFSE. This document can be use used for bidder's registrations, legislative donations, proposals, license renewals, etc. This certificate can be obtained 24 hours a day without visiting any of the Corporation's regional offices.

Other online services available at the CFSE internal portal are:

- debt certificates
- rate of experience plan certificates
- certificate code verification
- online filing of the Annual Payroll Statement
- policy payment
- file work accident report

To obtain coverage

To obtain coverage with the CFSE, Application for Insurance Quotation form must be completed and filed personally at the nearest agency office.

Link-CFSE Internet Portal
http://www.cfse.gov.pr
Link-Classification Manual
http://www.cfse.gov.pr/CMS/CMSFileStorage/20b2615790a432b9.pdf

At Kevane Grant Thornton we provide our clients with personalized attention, valuable advice and recommendations. Contact us if you have any questions related to this or any other matter.

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For assistance in this matter, please contact us via
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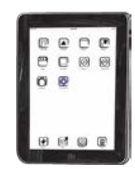

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