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Fitch: Puerto Rico's 2021 Audit Release a Key Administrative Step

Fitch Ratings-San Francisco/New York-21 June 2023: Puerto Rico's recent release of its fiscal 2021 audited basic financial statements indicates improved administrative capacity, according to Fitch Ratings. The commonwealth has also improved on the reliability, robustness, timeliness and accessibility of other supplementary information. Puerto Rico's ability to sustain improved budgetary, financial, and economic collection and reporting capabilities is a key component of any reasonable investigation Fitch would undertake in forming a credit view.

The June 12 release of Puerto Rico's fiscal 2021 audit (year-ended June 30) is a key component of the commonwealth's push to bring disclosures current following the restructuring of most of its debt in recent years. This follows fiscal 2019 and 2020 audits releases in Q2 and Q4 of 2022, respectively. The commonwealth anticipates publishing its fiscal 2022 audit by Q3 2023, and achieving a one-year audit lag with publication of its fiscal 2023 audit in Q2 2024.

A one year timeline would be a marked improvement for the commonwealth, but still lag peers in the municipal market. A recent study of release dates for annual comprehensive financial reports (ACFR's) by the University of Illinois, Chicago's Government Finance Research Center (UIC-GFRC) and Merritt Research Services found the median release time across the municipal market was 164 days for fiscal 2020. The National Association of State Comptrollers reports that for U.S. states, the average release time was 228 days for fiscal 2021. The median audit timeline for municipal governmental bond sectors has grown from 147 days in 2009 to 164 in 2020, according to the UIC-GFRC and Merritt Research Services study.

Anecdotally, several governments have reported to Fitch that pandemic disruptions, including steep declines in state and local government employment in 2020, contributed to longer audit timeframes. State and local government employment has since recovered, although it is still down slightly relative to 2019 averages.

Habitually delayed publication of audited financial reports beyond 270 days past the end of the fiscal year can indicate management weakness. GAAP-based financial reports are an objective and important source that Fitch and other market participants typically rely on to understand a government's financial performance. They provide a set of financial statements that comply with accounting requirements established by the Governmental Accounting Standards Board (GASB) and audited by an independent auditor using generally accepted accounting principles.

Audited financial statements present an official account of a government's financial condition for the last fiscal year, comparing it to prior fiscal years, and some include management discussion and analysis of the results.

When financial audits are delayed, Fitch typically relies on additional municipal transparency to perform its forward-looking analyses and continue assessing creditworthiness. Such transparency may include unaudited actuals, periodic revenue and expenditure budget performance reports, clear

budget documents, economic reportage and forecasting, and other disclosures.

Puerto Rico officials attribute the establishment of a timelier audit release schedule to post-PROMESA reform efforts executed in concert with the Oversight Board. Major commonwealth reforms include stronger budgetary policies, institutional budgetary reforms, wholesale modernization of financial collection and reporting systems, civil service reforms, and stronger internal controls. Together, these initiatives greatly bolster transparency and accountability, allowing external parties greater insight into major factors of the commonwealth's credit quality.

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