

**FINANCIAL OVERSIGHT AND MANAGEMENT BOARD
FOR PUERTO RICO**



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Executive Director

BY ELECTRONIC MAIL

July 14, 2020

The Honorable Wanda Vázquez Garced
Governor
Commonwealth of Puerto Rico

Dear Governor Vázquez Garced:

We write in response to the report submitted by the Government of Puerto Rico (the “Government”) pursuant to PROMESA section 203(a). This report pertains to the third quarter (“Q3”) of fiscal year 2020 (the “Quarterly Report”), in which the Government compared its quarterly General Fund Budget to Actuals as of March 31, 2020. As established by PROMESA section 203(a), these reports need to include, among other things, the actual cash expenditures as well as the projected expenditures contained in the Certified Budget.

After careful review, the Oversight Board has determined the Quarterly Report discloses material inconsistencies with the Certified Budget. Set forth below is a summary list of the inconsistencies, with more detailed explanation throughout the letter:

- (i) Significant underspend in actual PayGo as compared to budgeted PayGo disbursements (*see* Appendix A);
- (ii) Actual overspend and projected overspend in Payroll for several agencies (*see* Appendix B);
- (iii) Projected overspend in Operational Expenditures (“OpEx”) for several agencies (*see* Appendix C);
- (iv) Incomplete reporting of actual expenditures for several agencies;
- (v) Budgetary adjustments reflected in incorrect periods and late or no monthly closing of the accounting books and records; and
- (vi) Significant reported underspending of CapEx budgeted funds.

The Quarterly Reports advance the purpose of enabling Puerto Rico to achieve fiscal responsibility and access to the capital markets and, as part of those objectives, seek to improve fiscal governance, accountability, and internal controls on the Island. The Quarterly Reports also ensure the Government remains accountable to both the Oversight Board and the people of Puerto Rico. Therefore, accurate budget-to-actual reporting is of the utmost importance to the present and future fiscal health of the Commonwealth.

While the Oversight Board recognizes fiscal year 2020 (“FY20”) recently ended, this letter provides feedback on the Quarterly Report for Q3 of FY20 while it awaits the submission of the Section 203(a) Report for the entire fiscal year. In addition, this letter also requests additional information pursuant to PROMESA section 203(b)(1)(A).

The inconsistencies outlined by the Oversight Board are addressed below:

(i) Significant reported underspend in budgeted PayGo, as compared to actual PayGo disbursements showed in Appendix A

Per the Quarterly Report, the Government has spent \$983 million in PayGo expenditures, representing 51% of the total PayGo FY20 budget at the end of Q3 FY20. This suggests that the Government is either not properly registering PayGo spend as required by PROMESA section 203(a)(1), inadequately funding the Commonwealth’s pension system, or significantly over-budgeting the PayGo spend. Accurate spend projections and reporting allows for sustainable budgeting and adequate allocation of funds. As such, please provide the explanations as to why the significant variance exists between budgeted and actual PayGo amounts as well as the process used to reconcile budget versus actual amounts and projected spend on a quarterly basis. Moreover, the Oversight Board hereby requires an implementation plan for conducting a comprehensive audit of the pension rolls to ensure more appropriate budgeting.

(ii) Actual overspend and projected overspend in Payroll for several agencies

The following agencies reported a payroll overspend as of March 31, 2020:

1. Department of Housing;
2. Elderly and Retired Advocate;
3. Horse Racing Industry;
4. HR Management and Transformation ; and
5. State Elections Commission.

In addition to these agencies, there are approximately 30 additional entities projecting a payroll overspend by the end of FY20 (see Appendix B), for which we expect to see final results in the upcoming end of FY20 report.

These agencies have reported overspending their full FY20 payroll budget appropriation as of March 31, 2020. The sheer number of agencies that overspent their payroll appropriation for the entire fiscal year with three months remaining raises concerns that there is a lack of budgetary controls and no centralized accounting function in place to monitor government accounting. The disciplined implementation of the Certified Fiscal Plan and Certified Budget is critical to improve fiscal governance, accountability, and internal controls, which are all elements of achieving fiscal responsibility and renewed access to the capital markets.

We require the Government to provide an explanation of the above-mentioned inconsistencies and the corrective action it will take to ensure spending within the Certified Budget payroll limits in accordance with PROMESA section 203 (b).

(iii) Projected overspend in OpEx for several agencies (excluding CapEx and PayGo)

We have identified 22 agencies projecting an OpEx overspend as of June 30, 2020 (*see* Appendix C for a detailed list of the agencies and the amounts at issue). Please advise us of the cause of each overspend and which overspends, if any, represent advances of monies which will create a corresponding savings in the last quarter of FY20. We look forward to reviewing consistency with the Certified Budget's OpEx line items as we receive the full FY20 report later this month.

(iv) Incomplete or lack of reporting of actual expenditures in some agencies

The Solid Waste Authority reported 0% YTD spend and the Department of Treasury did not report its March actuals. The following agencies (with separate accounting systems) also do not report encumbrances:

1. Department of Treasury;
2. Department of Health;
3. Department of Education;
4. Mental Health and Drug Addiction Services; and
5. Puerto Rico Environmental Quality Board.

As such, please provide corrections for these deficiencies, details regarding the process followed to ensure complete and accurate reporting, and a revised report including actuals and encumbrances for the above-mentioned agencies. The Department of the Treasury's failure to report its actuals is deeply troubling. In fact, as one of the main financial institutions for the Government, the Department should set an example for other agencies regarding financial forecasts, accounting, and reporting. The requirement to provide for budgets in accordance with modified accrual accounting standards, as well as ensuring expenditures made during each fiscal year do not exceed revenues, are key elements of PROMESA. The failure to report General Fund expenditures, as required by PROMESA section 203(a), is more than an inconsistency. It is a matter of non-compliance.

(v) Issues on timing differences and recording of transactions in the reports for all three quarters and late monthly closing of accounting books

The Quarterly Report showed journal entry errors in all reported quarters. Specifically, errors of \$565 million, \$482 million, and \$217 million in journal entries were reported on the first, second and third quarters, respectively. Further, certain budgetary adjustments approved by the Board were recorded in the wrong accounting period. For example, several transactions approved in April were backdated and recorded for the month of March.

Governor Vázquez Garced

July 14, 2020

Page 4 of 7

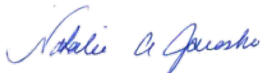
These two issues demonstrate the Government's current inability to close the accounting books on a timely basis. This affects the accuracy of the submission, and explains to some degree the annual delays in the issuance of Audited Financial Statements. Accurate and timely reporting is critical to improve fiscal governance, accountability, and internal controls as required by PROMESA section 201(b)(1)(F). As such, please provide the remedial steps to be taken and the Commonwealth's planned timeline of implementation to achieve accurate and timely reporting.

(vi) Significant underspending of CapEx funds

The Quarterly Report shows that only 22% of the allocated CapEx has been spent. We understand the Government was unable to invest or continue to utilize CapEx funds due to the COVID-19 pandemic lock down in March. However, the level of disbursement falls well-short of nearly six months of governmental activity. We encourage the Government to use the funds allocated for much needed long-term improvements on a timely basis and in accordance with a procurement plan less vulnerable to emergencies such as the COVID-19 pandemic. We urge you to review and redesign your current procurement processes to eliminate bureaucracy and create more efficient and cost-effective procedures.

We expect the Government to provide sufficient information and a corrective action plan to resolve the above-mentioned deficiencies. We emphasize the importance for the Government to take the remedial steps for the inconsistencies outlined in this letter and provide satisfactory explanations to the Oversight Board as well as the people of Puerto Rico. Accordingly, pursuant to PROMESA section 203(b)(1)(A), the Government is hereby required to provide to the Oversight Board detailed explanations no later than July 30, 2020.

Sincerely,



Natalie A. Jaresko

CC: Mr. Omar J. Marrero Díaz
Ms. Iris Santos Díaz
Hon. Francisco Parés Alicea

Appendix A: PayGo Underspend

FY20 General Fund Budget-to-Actuals						
Figures for 9 months, July through March						
Analysis includes actuals, errors, and encumbrances						
Overview						
\$ in thousands						
A. B2A pre- and post-adjustments						
Expense description	FY20 budget reported by AAFAP ¹	FY20 actuals (excl. errors, encumbrances)	FY20 journal entry errors	FY20 encumbrances	Overspend / (remaining) ²	% budget expended
PayGo for all agencies ⁴	1,932,367	-	983,127	-	(949,240)	51%

Appendix B: Payroll Projected and Actual Overspend

FY20 General Fund Budget-to-Actuals										
Figures for 9 months, July through March										
Analysis includes actuals, errors, and encumbrances										
Payroll - Overview (excl. EMSP Covid-19 \$787M)										
\$ in thousands										
A. FY20 General Fund payroll budget analysis (excl. EMSP Covid-19 \$787M)										
Agency	% of Q1 Budget Exp	% of Q2 Budget Exp	% of Q3 Budget Exp	FY20 budget reported by AAFAF ¹	FY20 YTD Total Expenses ²	Overspend / (remaining) ²	% of FY20 budget expended	% Projected Q4 Budget Exp ³	Projected % of full FY20 Budget expended	
Agencies over 75% YTD spend										
1 Department of Housing	51%	54%	51%	4,080	6,370	2,290	156%	52%	208%	
2 Elderly and Retired Advocate	33%	54%	33%	401	481	80	120%	40%	160%	
3 Horse Racing Industry	36%	39%	37%	1,036	1,156	120	112%	37%	149%	
4 HR Mgmt and Transformation	39%	33%	39%	1,773	1,966	193	111%	37%	148%	
5 State Elections Commission	35%	36%	34%	14,693	15,285	591	104%	35%	139%	
6 Public Broadcasting Corp	38%	32%	30%	4,107	4,107	-	100%	33%	133%	
7 Puerto Rico Ports Authority	0%	0%	100%	288	288	-	100%			
8 Housing Finance Corporation	0%	50%	50%	92	92	-	100%			
9 Trade & Export Company	0%	0%	100%	67	67	-	100%			
10 Office of Industrial Tax Exemption	0%	100%	0%	8	8	-	100%			
11 Public Housing Administration	0%	47%	47%	10	9	(1)	94%			
12 Civil Rights Commission	32%	36%	25%	399	368	(31)	92%	31%	123%	
13 Puerto Rico National Guard	31%	32%	28%	3,348	3,057	(291)	91%	30%	122%	
14 Department of Health	30%	30%	28%	63,938	56,408	(7,530)	88%	29%	118%	
15 Socio & Community Dev.	28%	30%	27%	1,694	1,433	(261)	85%	28%	113%	
16 Natural Resources Administration	28%	29%	28%	20,731	17,519	(3,212)	85%	28%	113%	
17 Department of Agriculture	28%	29%	27%	7,244	6,118	(1,126)	84%	28%	113%	
18 Institute of Puerto Rican Culture	27%	29%	26%	3,940	3,216	(724)	82%	27%	109%	
19 Transportation and Public Works	28%	28%	25%	17,277	14,064	(3,213)	81%	27%	109%	
20 Puerto Rico Planning Board	27%	27%	27%	6,825	5,526	(1,299)	81%	27%	108%	
21 Department of Labor and HR	23%	29%	28%	4,651	3,717	(933)	80%	27%	107%	
22 Veteran's Advocate Office	26%	28%	26%	656	525	(132)	80%	27%	107%	
23 Correction and Rehabilitation	25%	27%	27%	202,854	159,631	(43,223)	79%	26%	105%	
24 Department of Education	24%	28%	26%	915,776	713,197	(202,579)	78%	26%	104%	
25 DDEC	22%	29%	27%	771	600	(171)	78%	26%	104%	
26 Family and Children Admin	26%	24%	27%	52,417	40,645	(11,772)	78%	26%	103%	
27 Office of the Governor	26%	28%	24%	10,326	7,995	(2,331)	77%	26%	103%	
28 Office of the Women's Advocate	25%	27%	25%	1,289	987	(302)	77%	26%	102%	
29 Department of Justice	26%	25%	25%	67,282	51,454	(15,828)	76%	25%	102%	
30 Integrated Transit Authority	24%	29%	24%	11,355	8,652	(2,703)	76%	25%	102%	
31 P3 Authority	24%	28%	24%	1,275	970	(305)	76%	25%	101%	
32 Comprehensive Cancer Center	24%	28%	24%	3,502	2,656	(846)	76%	25%	101%	
33 Office of the Election Comptroller	26%	23%	27%	2,230	1,692	(539)	76%	25%	101%	
34 Office of the Citizen's Ombudsman	26%	26%	24%	2,239	1,696	(543)	76%	25%	101%	
35 "Peninsula de Cantera"	24%	26%	25%	445	337	(108)	76%	25%	101%	
Over 75% YTD Spend Subtotal	25%	28%	26%	1,429,021	1,132,291	(296,729)	79%	26%	106%	

Appendix C: OpEx Projected Overspend

FY20 General Fund Budget-to-Actuals								
Figures for 9 months, July through March								
Analysis includes actuals, errors, and encumbrances								
OpEx - Overview (excl. CapEx and EMSP Covid-19 \$787M)								
\$ in thousands								
A. FY20 General Fund OpEx budget analysis (excl. CapEx and EMSP Covid-19 \$787M)								
	Agency	% of Q1 Budget Exp	% of Q2 Budget Exp	% of Q3 Budget Exp	FY20 budget reported by AAFAF ¹	FY20 YTD Total Expenses ²	Overspend / (remaining) ²	% of FY20 budget expended
Agencies over 75% YTD spend								
1	PRASA	0%	0%	100%	6,388	6,388	-	100%
2	Public Broadcasting Corp	33%	31%	36%	1,558	1,558	-	100%
3	P3 Authority	3%	3%	92%	109,610	106,333	(3,277)	97%
4	Puerto Rico Health Insurance	56%	37%	0%	406,054	379,384	(26,671)	93%
5	Puerto Rico National Guard	5%	47%	41%	5,283	4,937	(346)	93%
6	The General Court of Justice	23%	24%	42%	70,865	63,156	(7,709)	89%
7	Child Support Administration	15%	37%	35%	3,128	2,724	(404)	87%
8	Department of Agriculture	16%	28%	44%	14,536	12,609	(1,926)	87%
9	Correction and Rehabilitation	40%	4%	42%	98,924	85,103	(13,821)	86%
10	Puerto Rico Department of State	4%	37%	44%	8,810	7,533	(1,277)	86%
11	Department of the Family	39%	4%	43%	13,164	11,166	(1,999)	85%
12	Vocational Rehabilitation Administration	21%	27%	36%	12,465	10,478	(1,986)	84%
13	Police Department	41%	17%	25%	245,055	205,257	(39,798)	84%
14	Veteran's Advocate Office	44%	16%	24%	1,570	1,299	(271)	83%
15	Office of Management and Budget	4%	52%	27%	37,927	31,370	(6,557)	83%
16	Consumer Affairs	41%	0%	41%	854	703	(151)	82%
17	Infrastructure Financing Authority	12%	12%	57%	835	680	(154)	82%
18	Legislative Assembly	39%	20%	20%	96,812	76,998	(19,813)	80%
19	Innovación y Tecnología (PRITS)	0%	0%	80%	3,026	2,407	(620)	80%
20	Office for the Patient's Advocate	41%	1%	36%	406	314	(92)	77%
21	Housing Finance Corporation	6%	6%	65%	33,037	25,418	(7,619)	77%
22	Department of Recreation and Sports	39%	0%	36%	10,229	7,713	(2,516)	75%
Over 75% YTD Spend Subtotal		38%	23%	27%	\$ 1,180,534	\$ 1,043,528	\$(137,007)	88.4%