



David A. Skeel Jr.
Chair

Members

Andrew G. Biggs
Arthur J. González
John E. Nixon
Betty A. Rosa
Juan A. Sabater

Robert F. Mujica Jr.
Executive Director

BY ELECTRONIC MAIL

March 18, 2024

Mr. Nelson Pérez Méndez
Interim Secretary
Puerto Rico Department of Treasury

Re: Fiscal Year 2020 and Fiscal Year 2021 Management Letters

Dear Mr. Pérez Méndez:

We write regarding the Fiscal Year 2020 and Fiscal Year 2021 Audit Management Letters (“FY2020 and FY2021 Management Letters”) produced by the Commonwealth’s auditor, KPMG, which identify deficiencies in the Commonwealth’s internal controls over financial reporting.

The Oversight Board is concerned with the material and significant weaknesses identified in the FY2020 and FY2021 Management Letters, including

- The Government performs no periodic evaluations over internal controls and has not taken remedial actions to address most of the control deficiencies identified in previous audits.
- The repetition of numerous deficiencies identified in previous management letters (see appendix I). For example, KPMG notes that “[m]anagement is required to design and implement effective internal control over financial reporting.”¹
- The lack of internal controls as well as other deficient accounting practices, such as the continued use of manual reconciliation processes, continue to result in the need to make significant audit adjustments to the financial statements.

¹ KPMG LLP to Management, the Honorable Governor, the Secretary of the Treasury, and the Legislature of the Commonwealth of Puerto Rico. *FY2020 Management Letter* (January 12, 2023); and *FY2021 Management Letter* (October 3, 2023).

The Oversight Board requests that the Puerto Rico Department of Treasury publish the FY2020 and FY2021 Management Letters and past management letters for the benefit of the people of Puerto Rico and relevant stakeholders. We continue to believe that this practice would demonstrate to the public the improvement the Government has made in its internal control environment.

PROMESA Section 209 sets forth the preconditions for the termination of the Oversight Board. The timely preparation and issuance of annual audited financial statements is a critical aspect for meeting those preconditions:

- Section 209(1) of PROMESA requires the Government to have “adequate access to short-term and long-term credit markets at reasonable rates to meet the borrowing needs of the territorial government.” As a practical matter, transparency consistent with municipal regulatory and market standards is one component of regaining market access. Accordingly, the Government must produce timely and accurate audited financial reports before it can secure adequate access to credit markets at reasonable rates.
- The audited financial statements are one of the components that Oversight Board will rely on to determine if the Government is meeting the balanced budget requirements of PROMESA Section 209(2)(B).²

The Oversight Board expects the Government to have adequate internal controls over its financial reporting functions so that the information reported in the financial statements is reliable and accurate. It is apparent from the FY2020 and FY2021 Management Letters that the Commonwealth continues to have material and significant deficiencies in internal controls that result in errors and misstatements that need to be adjusted as part of the audit process. Some of the areas that continue to have internal control deficiencies include:

- Information technology environment;
- GENTAX reconciliations and interphase with PRIFAS;
- Payroll management at Police Department;
- Capital assets recording;
- Recording of federal funds;
- Accounts payable and pension benefits reconciliation and recording;
- Reconciliation of cash accounts;
- Estimates of accrued compensated absences; and
- Act 70 benefits.

The appendix tables provide additional details of the FY2022 through and FY2018 independent audit findings.

² PROMESA Section 209(2)(B) requires the Government achieve and the Oversight Board certify that “for at least four consecutive fiscal years . . . the expenditures made by the territorial government during each fiscal year did not exceed the revenues of the territorial government during that year, as determined in accordance with modified accrual accounting standards.”

Mr. Pérez Méndez

March 18, 2024

Page: 3

In its letter dated August 17, 2022, the Oversight Board recommended, consistent with Government Auditing Standards, that the Government request draft management letters from KPMG prior to their final issuance³. Doing so will provide the Government with the opportunity to provide written comments on the deficiencies identified by KPMG and that final management letters consider the perspectives from the Government. As communicated by the Government, this recommendation was adopted before issuance of the FY2020 and FY2021 Management Letters, albeit the comments were provided by the Government orally. We commend the Government for the implementation of this practice; however, the Government should incorporate written communications, also consistent with Government Auditing Standards, providing additional transparency to the process.

The Oversight Board understands that many of the internal control deficiencies identified by KPMG, among other deficiencies, could be addressed by a new enterprise resource planning (“ERP”) system, which the Government is in the process of developing and implementing.

Accordingly, as part of the Government’s status update please provide to the Oversight Board for each weakness identified by KPMG:

- (1) how the weakness will be addressed in the ERP requirements design,
- (2) when the weakness will be addressed in the ERP roll out and
- (3) for any identified weakness which will not be addressed by the ERP, a plan for addressing.

The Oversight Board requires Treasury to submit the aforementioned documents (attachment 2) no later than **April 5th, 2024**.

The Oversight Board looks forward to continuing to work with you to ensure that the Commonwealth’s financial control environment is strong and subject to consistent review and improvement by the Department of Treasury.

Sincerely,



Robert F. Mujica Jr.
Executive Director

³ U. S. Government Accountability Office, Government Auditing Standards (the “*Yellow Book*”), GAO-24-106786 §§ 6.58-6.63 (Washington, D.C.: Feb. 1, 2024).

Mr. Pérez Méndez
March 18, 2024
Page: 4

Attachments

Attachment 1 –*Finding, Description and Example of Independent Audit Findings
Fiscal Years 2017-2021*

Attachment 2 –*Response Template*

Attachment I: Finding, Description and Example of Independent Audit Findings Fiscal Years 2017-2021

The Oversight Board expects the Government to have adequate internal controls over its financial reporting functions. However, it remains apparent from managements letters that the Commonwealth continues to have material deficiencies year to year in internal controls that result in errors and misstatements that need to be adjusted as part of the audit process (see tables 1 thru 5).

Table 1. Finding, Description and Example of Independent Audit Findings FY2021

Finding	Description	Example
1 (FY2021)	Failure to design and implement a formal risk assessment process to identify areas subject to material misstatement as part of financial operations, general accounting process and the preparation of the Commonwealth's basic financial statement.	Reports and relevant underlying data elements used in the assumptions of significant accounting estimates are not properly reviewed.
2 (FY2021)	Information and communication internal controls needs strengthening.	Information received through Circular Letters is not evaluated for relevance and reliability.
3 (FY2021)	Monitoring process internal controls are needed.	Decentralized accounting systems and control procedures, evaluations and not performed periodically.
4 (FY2021)	Control deficiencies over the information technology environment including access security, authorized user listing, data restoration and passwords.	Physical access to the Data Center is not managed, no record of approved users who are allowed to post transactions and lack of standard password policies.
5 (FY2021)	GENTAX – Inaccurate process and account for revenue transactions of its interphase with the general ledger application called Puerto Rico Integrated Financial System.	GENTAX rejected revenue transactions processed by taxpayers which were rejected by the Commonwealth's banking institutions.
6 (FY2021)	Reliability of underlying data used in accounting estimates.	Unreliable data used in computation of income tax receivables and income tax refunds payables accounting estimates.
7 (FY2021)	Monthly accounts payable subsidiary ledger.	Over accrued accounts payable misstatements.
8 (FY2021)	Federal revenue recognition.	Federal funds received not properly accounted for using applicable revenue recognition and eligibility requirements.
9 (FY2021)	GENTAX cash reconciliation errors.	Cash disbursement transactions through GENTAX are not properly reconciled to cash disbursement records due to GENTAX and PRIFAS interphase

		problems and ineffective manual bank reconciliation.
10(FY2021)	Capital assets incorrectly reported.	Incorrectly recording capital assets as general expenditures.
11(FY2021)	AOTC.	Incomplete and/or potential inadequate eligibility validation controls to detect ineligible AOTC related credits taken by taxpayers on income tax returns.
12(FY2021)	Incomplete trial balance.	Incomplete accounts payable and pension benefits.
13(FY2021)	Outstanding legal claim subledgers.	Incomplete and inaccurate legal loss contingencies and monetary exposure.
14(FY2021)	Reconciliation of cash accounts.	Failures in reconciliation of cash accounts such as, revenue and capital assets.
15(FY2021)	Restricted cash presentation.	Misstatements of Federal Funds.
16(FY2021)	Fiduciary activities.	Inability to validate accuracy of custodial funds.
17(FY2021)	Accrued compensated absences.	Spreadsheet formula errors resulting in financial reporting misstatements.
18(FY2021)	Puerto Rico Police Department (PRPD) ACA Sub-Ledger.	PRPD ACA manual sub-ledger excluded information for various employees.
19(FY2021)	Act 70 benefits accruals.	Errors found in Act 70 confirmations received related to beneficiaries.

Source: FOMB adaptation of KPMG independent audit report (October 3, 2023).

Table 2. Finding, Description and Example of Independent Audit Findings FY2022

Finding	Description	Example
Table 1 (FY2020)	Failure to design and implement a formal risk assessment process to identify areas subject to material misstatement as part of financial operations, general accounting process and the preparation of the Commonwealth’s basic financial statement.	Significant accounts are not reconciled on a timely manner.
2 (FY2020)	Information and communication internal controls needs strengthening.	
3 (FY2020)	Monitoring process internal controls are needed.	Decentralized accounting systems and control procedures contribute to difficulty in effective monitoring.

4 (FY2020)	Control deficiencies over information technology environment including access security, backup and data restoration, change management, incidents management and policies and procedures.	Terminated employees are not removed from system access and there are no emergency change policies that define what constitutes an ‘emergency change.
5 (FY2020)	GENTAX system interphase.	Unreliability in accounting for income tax transactions leading to inaccurate manual reconciliations between GENTAX and cash collected and reported.
6 (FY2020)	Payroll management and accounting structure – Police Department.	Accrued compensated absences or other compensation benefits related accruals to employees not adequately documented.
7 (FY2020)	Income tax receivables and tax refund payables estimates.	Controls are not in place to validate income tax collections/payments prepared by the Information Technology Division in the Department of Treasury.
8 (FY2020)	Lack of monthly accounts payable subsidiary ledger.	Over accrued accounting invoices.
9 (FY2020)	Revenue recognition.	Incorrect recording of Federal revenue.
10 (FY2020)	Salary debt estimate – Police Department.	Procedures and controls not in place to ascertain computation of debt estimates.
11 (FY2020)	Interests payable recorded in funded financial statements.	Accrued interest payable recorded did not include interest payable related to lines of credit.
12 (FY2020)	Conversion Entries – Debt Service Fund.	Proper conversion of fund financial statements into full failed to detect an error in revenue recognition.

Source: FOMB adaptation of KPMG independent audit report (January 12, 2023).

Table 3. Finding, Description and Example of Independent Audit Findings FY2019

Finding	Description	Example
1 (FY2019)	Failure to design and implement a formal risk assessment process to identify areas subject to risk of material misstatement as part of	Not all significant accounts, reports and underlying data elements used in significant accounting assumptions were not reconciled or reviewed properly.

	financial operations, general accounting process and the preparation of the Commonwealth's basic financial statement.	
2 (FY2019)	Monitoring process internal controls are needed.	Evaluations are not performed periodically over internal controls and remedial actions have not been taken for most of the control deficiencies identified in prior years.
3 (FY2019)	Unreconciled Cash Balances.	Over 100 accounts with an approximate estimate aggregate balance of \$151 million were not accounted for in the Commonwealth books, records or that were recorded in prior years.
4 (FY2019)	Immaterial corrections of errors.	Management did not properly oversee the preparation of their financial statements as it relates to the amounts for the component units for which the audited financial statements were not available in the 2018 audit. Potential magnitude of a misstatement is material to the financial statements.
5 (FY2019)	Control deficiencies over the information technology environment including access security, backup and data restoration, change management, incidents management, policies and procedures.	Physical access to the Data Center is not managed and reviewed for appropriateness. There are no information security policies established for the organization's systems and applications.
6 (FY2019)	GENTAX system interface with PRIFAS (GL).	Data interfaces are unreliable resulting in a reliance on manual reconciliation process between tax collections reported in GENTAX and the cash collected and reported by the banks resulted in a difference in recorded revenue by \$86.6 million, which was adjusted by Management.
7 (FY2019)	Accrued Compensated Absences and Accrued Salary – Police Department.	Automatic Data Processing, Inc. (ADP) (payroll service provider) tools have not been tailored to accurately pay salaries or manage accrued leave resulting in paid salaries inconsistent with Police Department human resource guidelines and Commonwealth labor laws.
8 (FY2019)	Income tax receivables and tax refund payables estimates.	Controls are not in place to validate accurate in income tax collections/payments prepared by the Information Technology Division in the Treasury Department (ATI)

9 (FY2019)	Voluntary termination benefits.	Liabilities for voluntary termination benefits are not accurately including certain benefit participants and/or their related balances communicated to the Employees' Retirement System of the Government for consideration in the calculation for the liability.
10 (FY2019)	Legal reserve.	Lack of controls to ascertain the level of precision in the final list of active legal cases provided by the Department of Justice.
11 (FY2019)	Accounts payable.	Lack of controls required to determine the level of precision in amounts under their established thresholds when reviewing payment after year end.
12 (FY2019)	Payroll Related Matters	No management review procedure or control to ascertain that newly hired employees' personal data is uploaded accurately into People Soft by the Administrative Personnel Affairs Office.

Source: FOMB adaptation of KPMG independent audit report (July 28, 2022)

Table 4. Finding, Description and Example of Independent Audit Findings FY2018

Finding	Description	Example
1 (FY2018)	Failure to design and implement formal risk assessment to identify areas subject to material misstatement as part of financial operations, general accounting process and the preparation of the Commonwealth's basic financial statement.	Not all significant accounts, reports and underlying data elements used in significant accounting assumptions were not reconciled or reviewed properly.
2 (FY2018)	Monitoring process internal controls are needed.	Evaluations are not performed over internal controls and remedial actions not taken for prior year deficiencies.
3 (FY2018)	Accrued Compensated Absences and Accrued Salary – Police Department	Automatic Data Processing, Inc. tools not been tailored to accurately pay salaries or manage accrued leave resulting in paid salaries inconsistent with human resource guidelines and Commonwealth labor laws.
4 (FY2018)	Control deficiencies over information technology environment including access security, backup and data restoration, change management,	Physical access to the Data Center is not managed or reviewed for appropriateness. There are no information security policies

	incidents management, policies and procedures.	established for the organization’s systems and applications.
8 (FY2018)	Relying on the underlying data used in the income tax receivables and tax refund payables estimates.	There are no controls in place to validate accurate in income tax collections/payments prepared by the Information Technology Division in the Treasury Department (ATI)
9 (FY2018)	Management Review of the Liability for Voluntary Termination Benefits	Liabilities for voluntary termination benefits are not accurately including certain benefit participants and/or their related balances communicated to the Employees’ Retirement System of the Government for consideration in liability calculation.
10 (FY2019)	Debt rollforward process.	The external consultant that prepares the debt rollforward does not confirm in writing the existence of potential debt activity (issuances, payments, refinancing) with the Puerto Rico Fiscal Agency and Financial Advisory Authority.
11 (FY2018)	Payroll related matters.	No management review procedure or control to ascertain that newly hired employees’ personal data is uploaded accurately into People Soft.

Source: FOMB adaptation of KPMG independent audit report (August 27, 2021).

Table 5. Finding, Description and Example of Independent Audit Findings FY2017

Finding	Description	Example
1 (FY2017)	Failure to design and implement a formal risk assessment process to identify areas subject to risk of material misstatement as part of financial operations, general accounting process and the preparation of the Commonwealth’s basic financial statement.	Lack of accounting standards implementation (GASB No. 68) and prior year material and significant deficiencies have not been remediated.
2 (FY2017)	Accrued Compensated Absences and Accrued Salary – Police Department	Automatic Data Processing, Inc. (ADP) (payroll service provider) tools have not been tailored to accurately pay salaries or managed accrued leave resulting in paid salaries inconsistent with Police Department human resource guidelines and Commonwealth labor laws.

3 (FY2017)	Review of Relevant Data Elements Used to Estimate the Legal Contingency Reserve	Lack of robust management review control procedures failed to detect inaccuracies resulting in corrected audit misstatements of \$35 million and net uncorrected misstatements of \$24 million related to the prior year.
4 (FY2017)	Control deficiencies over the information technology environment including: (i) access security, (iii) backup and data restoration, (iv) change management, incidents management and (v) policies and procedures.	Physical access to the Data Center is not managed and reviewed for appropriateness. There are no information security policies established for the organization's systems and applications.
5 (FY2017)	Relevant Data Elements Used to Estimate the Legal Contingency Reserve	No controls in place to validate data used to prepare the income tax receivable and income tax payable accounting estimates.
6 (FY2017)	Loss Contingencies – Clean Water State Revolving Funds	The Commonwealth assumed full responsibility of meeting federal requirements and did not account for an \$189 million understatement of contingent liabilities.
7 (FY2017)	Liability for Voluntary Termination Benefits	Liabilities for voluntary termination benefits are not accurately including certain benefit participants and/or their related balances communicated to the Employees' Retirement System of the Government for consideration in the calculation for the liability.
8 (FY2017)	Review of Open Invoices	Untimely identification of open invoices resulted in an under accrual of accounts payables and accrued expenses of \$27 million.
9 (FY2017)	Calculation of Unearned Revenue – Traditional Lottery	Lack of controls required to determine the level of precision in amounts under their established thresholds when reviewing payment subsequent to year end.
10 (FY2017)	Reconciliation of Amounts Reported as Due To/Due From the General Fund in the Traditional Lottery	There is no management reconciliation process to address completeness and accuracy of balances at year end. The Commonwealth of Puerto Rico will refund the Traditional Lottery for unsold lottery tickets during the fiscal year and also the prizes derived from the winning unsold tickets.

Source: FOMB adaptation of KPMG independent audit report (November 18, 2020).

Attachment II – Response Template

The following template has been prepared to facilitate the Department of Treasury’s status reporting on its progress to resolve each individual independent audit finding for Fiscal Years 2017 thru 2021.

Finding (# / Year)	Description	Concurrence	Status

Column Descriptions

Finding #

- Independent audit finding number and fiscal year.

Description

- Short description of the audit findings.

Concurrence

- Indicate whether the agency **agrees, partially agrees** or **disagrees** with the audit recommendation.

Status

- Provide detailed status update of the steps to address the audit recommendation.
- Include if the ERP will address the finding completely, if applicable.
- Include the time frame for final resolution (e.g., Q3 FY2025).