

# FINANCIAL OVERSIGHT & MANAGEMENT BOARD FOR PUERTO RICO



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## **BY ELECTRONIC MAIL**

February 26, 2021

The Honorable Pedro Pierluisi Urrutia  
Governor of Puerto Rico

Dear Governor Pierluisi Urrutia:

Pursuant to PROMESA section 205,<sup>1</sup> we write to provide a number of recommendations regarding Comprehensive Annual Financial Reports (“CAFRs”), the Enterprise Resource Planning system (“ERP”), and the Office of the Chief Financial Officer (“OCFO”).

As you know, PROMESA created the Oversight Board with a clear purpose: to provide a means by which Puerto Rico could achieve fiscal responsibility and access to the capital markets.<sup>2</sup> PROMESA provides clear guidance on how to achieve those objectives. For example, Section 201(b)(1)(F) states a fiscal plan shall, among other things, “improve fiscal governance, accountability, and internal controls.”

Section 209 of PROMESA also provides the Oversight Board will terminate when it certifies Puerto Rico: (1) “has adequate access to short-term and long-term credit markets at reasonable interest rates to meet [its] borrowing needs;” and (2) for at least four consecutive fiscal years, “the territorial government has developed its Budgets in accordance with modified accrual accounting standards” and “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.”<sup>3</sup> Clearly, responsible and sustainable fiscal governance is central to Congress’ statutory goals for Puerto Rico and a prerequisite for the Oversight Board’s termination.

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<sup>1</sup> PROMESA provides the Oversight Board may “at any time submit recommendations to the Governor or the Legislature on actions the territorial government may take to ensure compliance with the Fiscal Plan, or to otherwise promote the financial stability, economic growth, management responsibility, and service delivery efficiency...” *Id.* § 205. Additionally, the Oversight Board can adopt these recommendations and render them mandatory in subsequent certified fiscal plans. *Id.* § 201(b)(1)(K); *In re Fin. Oversight & Mgmt. Bd. for P.R.*, 945 F.3d 3, 7 (1st Cir. 2019) (nothing in PROMESA section 201(b)(1)(K) “precludes the Board from adopting a rejected recommendation if it otherwise has the power to adopt the recommended action on its own.”).

<sup>2</sup> PROMESA § 101(a).

<sup>3</sup> PROMESA § 209.

Over the past four years, the Government has made some progress in increasing transparency, implementing necessary governance reforms, and improving the timeliness of financial and other reporting. However, the institutionalization of fiscal responsibility depends in part on the Government taking three additional and crucial actions in the immediate future:

- (1) The completion of overdue CAFRs;
- (2) The development of a responsive ERP; and
- (3) The strengthening of the OCFO in the areas of financial reporting and auditing.

### **Action #1: Completing the FY2018, FY2019, and FY2020 CAFRs**

The Commonwealth must produce timely and accurate reporting on a consistent basis. Without timely and accurate information compiled on a modified accrual budgeting basis (*i.e.*, timely CAFR publication and Section 203 quarterly reporting), it is nearly impossible to monitor the Commonwealth's financial progress, confirm compliance with certified Budgets, and meet the requirements of PROMESA section 209 for the Oversight Board to terminate.

The timely publication of annual CAFRs remains significantly delayed for a number of reasons, including the inefficient and decentralized process currently used to prepare the reports. Specifically, the Government must coordinate more than 25 separate audit firms providing audit services to underlying component units. Manual output processes slow the transfer of information into financial statements. In addition, Commonwealth agencies utilize different, incompatible accounting systems, which leads to accounting discrepancies.

In two separate public hearings held this past summer, the Oversight Board communicated that the Commonwealth's CAFR issuance timeline was unacceptable and inconsistent with PROMESA. As the table below demonstrates, the most recently completed CAFR, for fiscal year 2017, was not issued until 38 months after the fiscal year ended. Currently, the Commonwealth is conducting the audit for fiscal year 2018, which, despite Oversight Board instructions to accelerate its completion, will not likely be issued until April 2021 — 34 months after the close of the fiscal year. Moreover, based on the projections provided by the prior administration for completing the FY2019 and FY2020 audits,<sup>4</sup> the delays in preparing financial reports will not be rectified anytime soon, an unacceptable situation that impedes the Commonwealth's ability to achieve fiscal stability and access to capital markets.

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<sup>4</sup> Indeed, the audits of many underlying component units for FY2019 and FY2020 have not even commenced.

Current issuance for FY18 and future CAFRs:					
Fiscal Year	Fiscal Year-End (FYE)	Oversight Board Rec. Timeline of CAFR	CW Expected Publication of CAFR	Oversight Board Months after FYE	CW's Months after FYE
FY2017	Jun '17	Aug '20	Aug '20	-	38
FY2018 <sup>1</sup>	Jun '18	Nov '20	Apr '21	29	34
FY2019 <sup>1</sup>	Jun '19	Dec '20	May '22	18	35
FY2020	Jun '20	Mar '21	May '22	9	23
FY2021	Jun '21	Dec '21	Apr '23	6	22
FY2022	Jun '22	Dec '22	Apr '23	6	10
FY2023	Jun '23	Dec '23	Mar '24	6	9

1. The FY2018 and FY2019 CAFRs have not yet been published.

This continued delay impairs the Government’s ability to achieve fiscal responsibility and is inconsistent with all public sector governing standards. The Governmental Accounting Standards Board (“GASB”), for instance, emphasizes timeliness over excess precision in the issuance of financial reports. In particular, GASB Concepts Statement No. 1 states “[s]ometimes a timely estimate is more useful than precise information that takes a long time to produce.” Currently, the Puerto Rico CAFRs are neither precise nor timely.

The importance of producing timely and accurate reports is echoed by the Government Finance Officers Association (“GFOA”). GFOA states that best practices require public reporting of financial information no later than six months after the end of the fiscal year. This reporting is to be based on the CAFR and, by implication, requires that the CAFR be issued within that same timeframe. Parties inside and outside of Government cannot reasonably rely on information in an untimely issued CAFR to assess the Government’s current finances. Should the Commonwealth fail to complete the overdue audited financial statements until some date far into the future, the Commonwealth’s ability to achieve fiscal stability and access to capital markets might be hampered.

**Action #2: Development of a Responsive ERP**

The Government currently relies on a disparate set of financial systems and controls to produce its financial statements and control expenditures. To institutionalize the ability to complete audited financial statements in a timely manner going forward, the Commonwealth has commenced a process to develop and implement a suitable system-wide ERP. The lack of a standard system-wide ERP is not, however, a reason to fail to produce basic financial statements or to fail to publish the overdue CAFRs. The proposed ERP, moreover, is nowhere near completion, even after years of work and the outlay of more than \$57 million (as of October 2020) in consulting contracts. Thus, the overdue CAFRs must be completed regardless of the status of the ERP.

To ensure future CAFRs are produced on a timely basis, the certified Fiscal Plan authorized an incremental \$36 million in spending, in addition to the \$57 million spent over the past four years, for ERP implementation. This capital expenditure funding was provided for the implementation of a new Government ERP system: \$14 million for Wave 1, which should have been completed by August 2020, and \$22 million for Wave 2, which should have been completed by February 2021. Despite the additional funding, Hacienda has still not completed Wave 1 of the ERP.

### **Action #3: Strengthening OCFO Authorities Related to Financial Reporting and Auditing**

By centralizing key financial management functions (*e.g.*, procurement, payroll) under a well-resourced OCFO, the Government will be in a position to address long-standing issues that have resulted from the Commonwealth's historically decentralized financial management regime. Such issues include persistent difficulties in understanding the financial needs and priorities across the Government resulting from lack of transparent data, lack of timely and accurate consolidated reporting, misallocation of funds, overspending of agency budgets, mismanagement of bank accounts, and late issuance of consolidated financial statements.

As part of the Federal Government's response to the pandemic, the OCFO will play a central role in administering and monitoring the use of COVID relief funds meant to support the Commonwealth's recovery. Empowering the OCFO to manage effectively the Government's finances is more important than ever in light of the devastating impact of the COVID-19 pandemic.

### **PROMESA § 205 Recommendations**

During calendar year 2020, the Oversight Board conducted public hearings and meetings with Hacienda personnel to discuss the completion of the CAFRs, implementation of the ERP, and the establishment of a robust OCFO. After considering all the information and documents provided by Treasury, the Oversight Board has prepared recommendations in this letter to ensure the elimination of the backlog of CAFRs, the proper implementation and management of the ERP, and the empowerment of an effective OCFO.

To meet our shared goal of ensuring the Commonwealth achieves fiscal responsibility and accelerating the time frame in which the Oversight Board is able to certify compliance with PROMESA section 209 and terminate, the Oversight Board, pursuant to Section 205(a) of PROMESA, makes the following recommendations:

#### **I. Recommendations to Bring the Commonwealth Current on its CAFRs**

CAFRs provide accurate and meaningful information concerning the Government's financial position, and provide financial transparency which promotes accountability. CAFRs are relied upon by many—inside and outside government—to understand the financial health of the Commonwealth and to inform decisions about how best to allocate the Commonwealth's scarce resources to meet its programmatic goals. To ensure the CAFR and underlying component unit audits are completed accurately and on a timely basis, the Oversight Board makes the following recommendations for immediate consideration:

1. Delink completion of CAFRs from the ERP and prioritize the completion of the CAFRs.
2. Perform a combined audit for the three (or more) years that are currently unaudited, which would bring current all outstanding CAFR audits for the Commonwealth by producing a CAFR for the three-year period ending June 30, 2020 (based on the most recent year audited and the most recent fiscal year ended).

3. Identify a team that will work exclusively on this combined audit with responsibility for marshalling the needed resources to address any obstacles to the expedited completion of the audits. The Governor should publicly charge this team with timely completion of the audits, ensure access to the necessary internal and contracted resources, and provide the team the authority to modify internal processes as necessary to ensure the timely issuance of future audited financial statements.<sup>5</sup> Members of this team should include the appropriate senior fiscal officers of the Government and the effort should be led by the OCFO.
4. Prepare a timeline, including resource needs and information input requirements, to complete the three-year CAFR.
5. Prepare a budget and resource report (to include necessary third party audit firms) to complete the three-year CAFR and FY2021 CAFR by the timeline set forth in item four, above.
6. Develop a plan to use decentralized resources, institutions, personnel, and expertise to complete the CAFRs as well as the development of a more centralized system of CAFR completion to improve existing systems and processes.
7. Identify staff to oversee the coordination and completion of the CAFR process from start to finish. The organizational reporting framework of this staff should incorporate parallel accountability of the component units and major agencies of the executive branch of the Government of Puerto Rico. The dedicated staff should provide a timeline and plan to complete the CAFR within six months of the close of each subsequent fiscal year.
8. Identify bottlenecks and obstacles that may exist (excluding ERP implementation) and present the findings and solutions to the Oversight Board.

## **II. The Government Should Prioritize Implementation of the ERP Over Other Initiatives – Other Than Completion of the CAFRs**

As the ERP project stands now, it lacks senior level commitment and direction, dedicated senior management, and a dedicated implementation team within the Government. If these leadership and management positions are not filled, the project will continue to consume large amounts of financial and human resources with little hope of progress, much less completion. The Government has already spent \$57 million on ERP-related consulting contracts over the past four years alone, while Wave 1 (solely at Hacienda) implementation remains incomplete.

The Oversight Board makes the following recommendations for your immediate consideration to support the successful implementation of the ERP. These recommendations are based upon the successful implementation of the ERP in Detroit in response to its own financial crisis:

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<sup>5</sup> The GFOA provides guidance on steps that should be taken to completely refocus the internal efforts around a process that will ensure timely audited financial reports, which can be found here: <https://www.gfoa.org/materials/timely-financial-reporting>.

1. Create a Project Steering Committee to oversee ERP project implementation. In addition to guiding the overall project, the Committee must mitigate the impact of implementation on the various agencies and departments of the Government, allowing these agencies and departments to continue to serve the people of Puerto Rico during ERP development. Further, the Project Steering Committee should immediately hire an ERP manager.
2. Coordinate with the Oversight Board to staff the Project Steering Committee with high-level Commonwealth officials from various segments of the Government.
3. Create an ERP project management team to facilitate implementation of the ERP in Puerto Rico and coordinate with the Oversight Board to create roles and job descriptions for the ERP project management team. Assure the management team has adequate access to, and understanding of, the various systems and functions required to obtain necessary financial information to conduct its work. The team must be organized and staffed in a manner sufficient to access these systems and information. The Project Steering Committee should provide monthly updates of progress to the Governor and the Oversight Board.
4. Review and assess the progress of implementing the ERP and determine how best to ensure its timely completion. This should include: assessing and, as necessary, revising project milestones and assigning ERP implementation staff with responsibility for achieving them; setting an aggressive, but realistic timeline for each project milestone; and calculating a budget to complete the project. The new milestones, identified staff, and budget requirements should be presented to the Oversight Board.
5. Create a cash management system providing the Government and the Oversight Board immediate, real time, computer access to: (i) all cash of the Commonwealth and each of its instrumentalities; (ii) all checks and wire transfers received and disbursed by the Commonwealth and each of its instrumentalities; (iii) all accounts receivable and accounts payable of the Commonwealth and each of its instrumentalities (after transitioning to modified accrual accounting); and (iv) comparisons of each certified budget to actual paid and accrued revenues and expenses.

If the Government is unwilling or unable to adopt these recommendations to prioritize the successful completion of the ERP, then the Government should pause the ERP project indefinitely.

### **III. The OCFO Should Have a Significant Role in Financial Reporting and Auditing, as well as Supporting ERP Development and Implementation**

Chapter 14 of the Commonwealth Fiscal Plan outlines the roles and responsibilities of a successful OCFO. The OCFO core objectives include, among other things:

- Centralizing the Treasury and liquidity management.

- Enhancing the budget development process by improving monitoring and performance tracking based on timely and accurate accounting practices and data.
- Driving the standardization and integration of the Government's financial IT systems.
- Ensuring compliance with procurement, contract, and human resource management policies across Government agencies.
- Ensuring full implementation of pension policies across Government agencies.
- Strengthening oversight of Special Revenue Funds through enhanced control mechanisms.
- Improving the timeliness in publication of the Government's CAFRs and financial reporting.
- Centralizing and validating the management of Government bank accounts, funds, debts, and other financial transactions.
- Ensuring coordination of maximally efficient use and transparent reporting of federal funds, including both regular annual funds and disaster-related funds.

A centralized OCFO would provide the accountability and oversight required to complete the CAFRs in a timely fashion and successfully implement the ERP system. Accordingly, the Oversight Board makes the following recommendations:

1. Identify the financial management, accounting and reporting standard setting, review, internal audit and reporting functions for which the OCFO is responsible. Exercise management and review control and establish an organizational framework and appropriate staffing accordingly.
2. Develop an organizational framework or system to coordinate these work streams and cooperate with other Government entities in those circumstances where the OCFO has no direct management control over those that are performing the functions.
3. Benchmark the organizational framework against entities within the Commonwealth and other OCFO organizations at a functional level to identify: (i) functions that may have been omitted; and (ii) other ways of organizing to meet functional needs. This process will also help to identify common financial functions across the Commonwealth that might be ripe for consolidation or restructuring.
4. Identify specific positions that are needed to support these functions, and the skills and competencies needed to accomplish them.
5. Develop a system-wide process document to ensure completion of the CAFR within six months after the close of each fiscal year. This document should provide system-wide

accountability for assembling and reporting the sources and uses of all Commonwealth funds to ensure timely completion of audits and financial reporting. The OCFO should have full oversight and authority for the construction of the CAFR and be held accountable for any delays.

6. The OCFO should take a central role in the implementation of the ERP system including the following:
  - a. Coordinate the secretaries and directors of all financial management offices within the Government to ensure all parties are working toward the goal of implementing an ERP system in a swift, orderly, and effective process outlined by the Project Steering Committee;
  - b. Oversee the ERP system implementation for the financial management and reporting modules;
  - c. Identify disparate systems being used for financial tracking and reporting;
  - d. Establish a roadmap to standardize and integrate systems to the fewest possible; and
  - e. Orchestrate the integration across agencies, including defining new policies and procedures, coordinating data migration and validation, and training users to effectively utilize new systems.
7. Evaluate current laws which exempt certain Government entities from the Puerto Rico Government Accounting Act. Regardless, while some entities are mandated by law to maintain fiscal independence, these entities could still leverage central financial IT systems to reduce costs and automate current processes.

A properly structured and empowered OCFO will constitute an important organizing entity for the pursuit of these (and related) financial reporting and resource management and planning objectives. Ultimately, PROMESA requires the institutionalization of sound financial management and fiscal responsibility within the Commonwealth Government. Cooperation between the OCFO and the primary fiscal entities and officers of Puerto Rico will be essential in achieving these objectives.

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As you are aware, PROMESA section 205(b)(1) requires you respond to these recommendations within ninety (90) days, submitting a statement that provides notice as to whether the Commonwealth will adopt the recommendations. If you intend to adopt some or all of these recommendations, PROMESA section 205(b)(2) requires that you include in your response a written implementation plan that includes: (i) specific performance measures to determine the extent to which the territorial government has adopted the Oversight Board's recommendation(s);

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and (ii) a clear and specific timetable pursuant to which the territorial government will implement the Oversight Board's recommendation(s).<sup>6</sup>

If, instead, you decline to adopt any or all of the recommendations, you must provide explanations for your rejection of those recommendation(s) and submit such statement of explanations to the President of the United States and the United States Congress.<sup>7</sup> Please be advised, the recommendations made herein to remedy the identified deficiencies are so fundamental to the Commonwealth's recovery that their rejection will likely lead the Oversight Board to make them mandatory in the next fiscal plan.

We are happy to work directly with your office, staff or any other entity of the Commonwealth in pursuit of these recommendations and to facilitate their development and implementation, including participation in any design or necessary organizational processes for which we might be of assistance.

We look forward to continuing to work together for the benefit of the people of Puerto Rico.

Sincerely,



Natalie A. Jaresko

CC: Mr. Omar Marrero Díaz  
Mr. Francisco Pares Alicea

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<sup>6</sup> PROMESA § 205(b)(2).

<sup>7</sup> Pursuant to PROMESA section 205(b)(3).