

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



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*Natalie A. Jaresko*  
Executive Director

**BY ELECTRONIC MAIL**

May 10, 2018

Honorable Ricardo A. Rosselló Nevares  
Governor of Puerto Rico  
La Fortaleza  
PO Box 9020082  
San Juan, PR 00902-0082

Dear Governor Rosselló Nevares:

This letter serves as a Notice of Violation pursuant to Section 202(c)(1)(B) of PROMESA that the Oversight Board has determined, in its sole discretion, that the proposed Commonwealth of Puerto Rico budget for fiscal year 2019, submitted to the Oversight Board on May 4, 2018, is not compliant with the New Fiscal Plan for Puerto Rico as certified by the Oversight Board on April 19, 2018 (the “New Fiscal Plan”). The Oversight Board looks forward to reviewing a revised budget that it hopes it can determine is compliant with the New Fiscal Plan so that the Oversight Board can submit it to the Legislature on or before the deadlines set forth in this letter.

**Background**

At the Oversight Board’s eleventh public meeting, held on December 5, 2017, the Oversight Board outlined an approach to the FY19 integrated budget review process, including guiding principles and key milestones.

By letter dated December 12, 2017, the Oversight Board, pursuant to Section 202(a), set a schedule for the Governor’s submission to the Oversight Board of the proposed budget for FY19, and requested that the budget be prepared in accordance with the principles provided by the Oversight Board.

Hon. Ricardo A. Rosselló Nevares

May 10, 2018

Page 2 of 6

By letter dated December 21, 2017, the Oversight Board provided a revised schedule for the FY19 budget process due to the delay in the certification of the New Fiscal Plan.

By letter dated January 5, 2018, the Oversight Board provided guidelines for Milestone 1 (complete inventory listing), which was due on January 10, 2018.

By letter dated February 5, 2018, the Oversight Board provided guidelines for Milestone 2 (proposed revenues), which was due on February 23, 2018.

By letter dated February 22, 2018, the Oversight Board provided a revised schedule for the FY19 budget process due to the delay in the certification of the New Fiscal Plan.

By letter dated April 24, 2018, the Oversight Board set deadlines for intermediate steps before the FY19 budget for the Commonwealth could be adopted and set May 4, 2018 as the date by which the Governor must provide his proposed budget and supporting details. These supporting details had to include a detailed reconciliation between the budget and the New Fiscal Plan, as well as budget to actual templates, which included key performance indicators for reporting post-certification. The Oversight Board also requested that all New Fiscal Plan attributes, including reserves, revenue and expenses measures, be incorporated into Milestone 4 (proposed expense budgets and reporting templates), and required that total expenditures be consistent with the New Fiscal Plan. Finally, the Oversight Board provided the revenue forecast as required by Section 202(b).

By letters dated April 26, 2018 and May 2, 2018 (together, the “Guidance Letters”), the Oversight Board provided additional guidance regarding the development, approval, and certification of the budget in advance of the delivery of the materials required by Milestone 4. The Guidance Letters required the delivery of proposed expense budgets and reporting blueprints.

### **Government’s Submission**

The Government’s submitted budget is not compliant with the New Fiscal Plan, and it does not meet the requirements set forth by the Oversight Board in its correspondence with the Government. The Oversight Board requires substantial revisions and additional information from the Government before it could approve the Government’s proposed budget and submit it to the Legislature.

Pursuant to Section 104(c), we request all outstanding information in our correspondence with the Government as outlined above. This will enable the Oversight Board to review the proposed budget in its entirety and determine its compliance with the New Fiscal Plan.

A summary of items that remain outstanding are included below. Please refer to the Appendix of this letter for a status update on compliance with the full set of requirements established by the Oversight Board.

### **Preliminary Status Update of Materials Not Submitted**

The following materials required by the Oversight Board were not provided or included with the proposed budget submitted by the Government:<sup>1</sup>

<b>FY19 Consolidated Budget</b>	<p>A detailed budget of expenses for FY19 consistent with the New Fiscal Plan. From the General Fund material provided, these items, among others, appear inconsistent with the New Fiscal Plan:</p> <ul style="list-style-type: none"><li>- No inclusion of UPR and Workforce Development reinvestments generated from comprehensive labor reform</li><li>- Lack of a Commonwealth appropriation to ASES</li><li>- Inclusion of additional reserves beyond the \$130 mm emergency reserve in the Fiscal Plan</li><li>- Inclusion of \$100 mm to municipalities for regionalization of services, which is separate from \$176 mm in Fiscal Plan appropriations and not included in the Fiscal Plan</li><li>- Inclusion of Christmas Bonus payments to employees</li><li>- \$3.5 mm for State Revolving Funds instead of \$114 mm enumerated in the Fiscal Plan</li><li>- \$33 mm for Police employees inclusion of Social Security payments</li><li>- No inclusion of \$132 mm of unallocated CapEx</li><li>- Utility payments that are inconsistent with projections</li><li>- No agency holdbacks of 5% as its own concept of spend</li><li>- Incorrect appropriations</li></ul>
<b>FY19 General Fund Budget Resolutions</b>	<p>Supporting detail for the General Fund resolution</p> <p>Control language, including reporting, holdback, and accounts payables, sent by the Oversight Board in our letters to you</p> <p>Preliminary budget balances by concept of spend by agency</p>

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<sup>1</sup> Preliminary observations of violations identified as of May 9, 2018, include inconsistencies with the Fiscal Plan, incomplete submission, guidance not followed and missing support.

<b>FY19 Budget to Fiscal Plan Reconciliation</b>	A reconciliation of the budget to the Fiscal Plan for expenditures with explanations of any variance
<b>Underlying Assumptions, Supporting Detail and Documentation</b>	Supporting documents evidencing underlying assumptions for the FY19 Consolidated Budget
<b>Reporting Templates</b>	Preliminary draft versions of reporting templates. These were due as part of Milestone 4 Deliverables, with blueprints to be finalized within 30 days after year end (July 30, 2018)
<b>Expense Measures by Agency/Public Corporation</b>	Insufficient information has been provided to assess whether the Governor’s FY19 Budget resolutions include FOMB’s detailed mapping of the measures to each instrumentality for use in developing the fiscal year 2019 budget, including reinvestments afforded by expense measures and rightsizing measures by personnel and non-personnel cost categories

**Conclusion**

The Oversight Board recognizes the hard work required to fulfill the FY19 budget milestones, and appreciates the Government’s leadership in proposing a budget for FY19. However, the Oversight Board takes exception to the allegation that “the FOMB did not consult with the Governor or Puerto Rico’s Legislature in devising the schedule” for development of budgets pursuant to Section 202(a). There was significant collaboration and discussion between the Oversight Board, the Government, and our respective advisors in the preparation of the information requested. From December 2017 to April 2018, the Oversight Board shared more than seven letters on the topic with various Government officials. Moreover, the Oversight Board met in person dozens of times with members of OMB, AAFAF and Hacienda (as well as their advisors) to consult on the proposed schedule for the development of budgets. The Oversight Board also met separately with members of the Legislature to consult on the proposed schedule for the development of budgets.

\* \* \*

Pursuant to Section 202(c)(1)(B), please submit a budget that corrects the violations described in this letter no later than 12:00pm on May 15, 2018.

We are committed to reviewing the revised submission promptly and believe this deadline provides the Government with adequate time to submit a budget that is compliant with the New Fiscal Plan and to provide the requested information and documentation.

Hon. Ricardo A. Rosselló Nevares

May 10, 2018

Page 5 of 6

Sincerely,



Natalie A. Jaresko

José B. Carrión

Andrew G. Biggs

Carlos M. García

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Ana J. Matosantos

David A. Skeel, Jr.

CC: Christian Sobrino Vega

Gerardo Portela Franco

Hon. Ricardo A. Rosselló Nevares  
May 10, 2018  
Page 6 of 6

## **Appendix**

Puerto Rico Milestones Checklist - Commonwealth

	Guideline Description	Date Received	Status	Violation
1	Provide a detailed budget of expenses for FY19 that is consistent with the trajectory for the primary fiscal balance in the Fiscal Plan, using the same basis of accounting used to prepare the Fiscal Plan (modified accrual basis of accounting) and in accordance with the accounting policies used to prepare the audited financial statements of the Commonwealth. If the basis of accounting is different than modified accrual, please confirm the basis of accounting being used.		Outstanding	Incomplete submission
2	Provide a reconciliation of the budget to the Fiscal Plan for expenditures with explanations of any variance. However, it is not expected that total expenditures would deviate from Fiscal Plan submitted and approved. To the extent the budget changes after May 4, provide the updated reconciliation in excel within five business days of the update and no later than eight business days before certification of the FY19 budget.		Outstanding	Incomplete submission
3	Provide additional detail on expenditures:		Outstanding	Incomplete submission
3a	Where available, provide a comparison of expenditures to prior two budgets and to prior two years of actuals (where available) and latest twelve ("LTM") months ending December 31, 2017 of actuals and explain key differences. If the actuals for the prior two years or LTM period, are just draft versions, indicate so when providing the information		Outstanding	Incomplete submission
3b	Provide support for FY19 expenditures estimates by major expenditure category by agency and by fund, including key economic, demographic, policy and other assumptions affecting expenditure trends, and comparisons to historical periods. To the extent these differ significantly from those used in the Fiscal Plan, please explain significant differences and provide explanations for these differences.		Outstanding	Incomplete submission
3c	Provide breakdown of major categories of total revenues and expenditures by month and by quarter, so that the sums across months and quarters equal total revenues and expenditures in the proposed annual budget. Please identify underlying assumptions driving the monthly budgets (ie. seasonality, historical patterns, etc.). Prepare detailed monthly cash flow projections for the budget period and a reconciliation between cash flow projections and the monthly breakdown described above		Outstanding	Incomplete submission
4	Provide greater transparency of payroll related expenses:		Outstanding	Incomplete submission
4a	Provide projected employment levels ('full time employees', 'transitory employees' and 'at will employees'[1]) by agency/public corporation. Please provide key terms of collective bargaining agreements and other labor related costs (including benefits, early retirement programs, etc.) for FY19 that are consistent with the Fiscal Plan. Please provide a comparison with projected and actual numbers in FY18.		Outstanding	Incomplete submission
4b	Provide details of transitory employee levels by agency (headcount and cost), not included above, and in total.		Outstanding	Incomplete submission
4c	Provide details of vacant positions, frozen positions (per Acts 70, 211 and any other early retirement programs). Please provide a comparison with projected numbers of FY18.		Outstanding	Incomplete submission
4d	d. Provide details of Christmas Bonus amounts included as part of the payroll appropriations for each agency.		Outstanding	Incomplete submission
4e	e. Provide savings/costs estimates for Law 70, Law 211 and/or VTP by agency and confirm where they are located in the budget. Identify any other ongoing/new incentive programs and impact in the FY19 Budget by agency/public corporation.		Outstanding	Incomplete submission
4f	Provide details of personnel service contracts by agency (headcount and cost) and in total. Please provide a comparison with actual numbers in FY18.		Outstanding	Incomplete submission
5	Identify all reserves within the Budget and provide a reconciliation back to the Fiscal Plan to evidence consistency between both. Identify restrictions and/or requirements around each reserve and where FOMB approval is required to access. Provide reporting blueprint for reserve balances, identifying major categories of usage, dates used and nature of each expense. Provide a contingency plan to ensure provision of critical services in the event that reserves set aside are insufficient.		Outstanding	Incomplete submission
6	Include Paygo contributions related to the pension plan in excess of asset balance, consistent with the Fiscal Plan. Provide a detailed analysis of the Paygo calculation and components by retirement system, agency and fund, including: Retirement Benefits, Special Laws, Other Benefits, Expected Asset Sales, Contributions from entities outside of budget, Admin Costs		Outstanding	Incomplete submission
7	Provide for reasonable and necessary capital expenditures consistent with the Fiscal Plan. Please provide detail in FY19 budget document and justification for large capex. Please provide comparison of FY19 budgeted expenses to FY18 actual expenses incurred. Please provide 3-5 year capex plan (if applicable). Provide separate breakouts and descriptions by project of the nature of the capex where the capex is expected to be funded by a third party source such as FEMA.		Outstanding	Incomplete submission
8	Provide amounts and descriptions of all new expenditure measures included in the budget and reconcile to measures identified in the Fiscal Plan. Please ensure measures can be mapped by agency by concept of spend, and by fund and that they can be measured and success tracked from July 1 onwards.		Outstanding	Incomplete submission
9	Identify one-time revenues and expenditures and provide amounts and descriptions of each stream of revenue and expenditure.		Outstanding	Incomplete submission
10	Provide for costs, such as legal and other expenses, associated with the process of debt restructuring and collection of debts, this should include underlying support for legal and other professional fees included in the budget, including historical actual professional fees by professional firm incurred in FY18 and submitted as part of the fee examination process. Identify total legal/professional fees paid by the Commonwealth on behalf of other agencies/instrumentalities in prior year. Legal and professional costs should include: Non-Title III expenses related to the government and FOMB and Title III expenses related to all parties (including assumptions underlying budgeted expenses)		Outstanding	Incomplete submission
11	Where applicable for FY19 Budget, Provide for the costs associated with Office of the Chief Financial Officer ("OCFO") to comply with all the financial reporting requirements of PROMESA and as identified in the Fiscal Plan. Provide underlying support for budgeted costs.		Outstanding	Incomplete submission
12	Reaffirm that the Government is in compliance with the requirement that appropriations are not being carried over from prior fiscal periods and/or are subject to restrictions identified in Budget resolutions:		Outstanding	Incomplete submission
12a	Identify if there are any exceptions to complying with the resolutions and explain why.		Outstanding	Incomplete submission
12b	Provide a total balance of outstanding encumbered amounts as at year end, and confirm amount that has been included as part of the budget. Please provide on an agency by agency basis, where information is available.		Outstanding	Incomplete submission
13	Please outline next steps and timeline to move all accounting of payables/accruals outside of the system into the Government's accounting system.		Outstanding	Incomplete submission
14	Identify potential risks and opportunities within the budget and mitigating factors steps the Government is taking to reduce risk and maximize the opportunity on each.		Outstanding	Incomplete submission
15	Provide the detail of spending by program, including the comparison of FY19 budget to projected FY17 expenses and YTD FY18 expenditures.		Outstanding	Incomplete submission
16	Provide reporting templates and additional information as requested below.		Outstanding	Incomplete submission
16a	Provide consolidated Budget to Actual blueprint reporting templates, identifying the following where applicable:		Outstanding	Incomplete submission
16a(i)	Agency numbers and names		Outstanding	Incomplete submission
16a(ii)	Budgeted expenditures for each type of fund per agency (General Fund, Special Revenue Funds, Federal Funds, Other Income)		Outstanding	Incomplete submission
16a(iii)	Actual expenditures for each type of fund per agency (General Fund, Special Revenue Funds, Federal Funds, Other Income)		Outstanding	Incomplete submission
16a(iv)	Annual budgets split into monthly budgets for the year		Outstanding	Incomplete submission
16a(v)	Expenditures to be reported on a periodic basis as well as a cumulative basis		Outstanding	Incomplete submission
16a(vi)	Assumption underlying budgets		Outstanding	Incomplete submission
16a(vii)	Materiality thresholds that will guide requirements for further explanations for significant variances		Outstanding	Incomplete submission
16a(viii)	Explanations for key variances		Outstanding	Incomplete submission
16a(ix)	Names of individuals responsible for providing reporting on a regular basis (including contact names, email addresses and numbers)		Outstanding	Incomplete submission
16a(x)	A calendar/timeline for the year identifying timing for ongoing reporting on a monthly basis		Outstanding	Incomplete submission
16b	Provide templates for additional reporting, including:		Outstanding	Incomplete submission
16b(i)	Reporting on measures identified as part of the Fiscal Plan		Outstanding	Incomplete submission
16b(ii)	Other specific reporting requirements identified as part of the Fiscal Plan (including, but not limited to, reporting on liquidity, payroll/headcount/attendance, Paygo)		Outstanding	Incomplete submission
16b(iii)	Summary Budget to Actual ("B2A") report on Consolidated Budget		Outstanding	Incomplete submission
16b(iv)	Emergency-related Federal Funding requested/drawn (including FEMA and non-FEMA funds)		Outstanding	Incomplete submission
16b(v)	Annual tax expenditure report ("TER") requirement		Outstanding	Incomplete submission
17	Provide unique account string for all possible combinations of fund, agency, concept, program, budget year. Submit draft of combinations to Hacienda prior to budget certification for necessary PRIFAS programming and testing in preparation of certified Budget upload on July 1.		Outstanding	Incomplete submission
18	Provide a list of merged/deleted agencies and/or new additional agencies.		Outstanding	Incomplete submission
19	Provide preliminary draft budget resolutions to be submitted for Legislature for review and comment.	5/4/2018	Received	Inconsistent with Certified Fiscal Plan Incomplete submission FOMB guidance not followed Missing support
20	Provide all items above, where applicable (i.e. numerical inputs and outputs), in Excel.		Outstanding	Incomplete submission

Puerto Rico Milestones Checklist - Public Corporations in the CW Budget

	Guideline Description	Date Received	Status	Violation
1	Provide a detailed budget of total expenditures defined in this document to include operating expenses and separately capital improvement plan ("CIP") expenditures for FY19 that is consistent with the trajectory in the Fiscal Plan covers transactions conducted by all subsidiaries. There should be a detailed breakout of operating expenses.		Outstanding	Incomplete submission
2	Provide a reconciliation of the budget to the Fiscal Plan with explanations of any variance. However, total expenditures should not deviate from the Fiscal Plan operating expenses and CIP submitted and approved. To the extent the budget changes after May 4, 2018 based upon specific information not known at that time, provide the updated reconciliation in excel within five business days of the update and no later than eight business days before certification of the FY19 budget.		Outstanding	Incomplete submission
3	Provide a comparison of expenditures to the prior two budgets (FY17 and FY18) and to the prior two years (FY16 and FY17) and year-to-date ("YTD") from July 1, 2017 through March 31, 2018 of actuals versus July 1, 2016 through March 31, 2017. Explain key differences by both \$ and % differences for any variance over 10%. If the actuals for the prior two years or YTD period are draft versions, indicate so when providing the information.		Outstanding	Incomplete submission
4	Provide support for FY19 expenditures estimates by major expenditure category. To the extent these differ by over 10% from those used in the Fiscal Plan or in the prior two years (FY17 and FY18), explain significant differences and provide explanations for these differences. Identify expenditures that are related to recovery due to the Hurricanes and separately expenditures that are needed to continue to provide basic services. Identify potential risks and opportunities within the budget and mitigating steps being taken to reduce risks and maximize opportunities.		Outstanding	Incomplete submission
5	Provide breakdown of major categories of total revenues and total expenditures by month and by quarter. The sums across months and quarters should equal total revenues and total expenditures in the proposed annual budget considering seasonality and other factors specific to the instrumentality / public corporation.		Outstanding	Incomplete submission
6	Provide accounts payable information as of March 31, 2018. For materiality purposes, this should include top 20 vendors and a total for all others.		Outstanding	Incomplete submission
7	Provide accounts receivable information as of March 31, 2018. This information should also include aging by days (0-30, 31-60, 60-89, 90+ or other aging report grouping currently utilized). Provide information on total allowance for doubtful accounts.		Outstanding	Incomplete submission
8	Provide total projected full-time employee headcount and cost for FY19, and attendance report that is consistent with the format already in place. Please provide a comparison with actual numbers in FY17 and FY18. To the extent there are temporary employees, identify the total headcount and related costs.		Outstanding	Incomplete submission
9	Provide amounts and descriptions of all new revenue and expenditure measures / initiatives included in the budget. There should be a clear mapping of the revenues, operating expenses and CIP, if any, to tracked line items in the budget so that the measures can be easily tracked and traced to specific line items.		Outstanding	Incomplete submission
10	Identify one-time revenues and expenditures and provide amounts and descriptions of each one time item.		Outstanding	Incomplete submission
11	Provide monthly and year-to-date blueprint budget to actuals ("B2A") reporting templates, identifying the following where applicable:		Outstanding	Incomplete submission
12	Provide a schedule of total revenues, total expenses broken by fund type – general fund, federal fund, other fund – and, separately, capital improvement plan ("CIP") expenditures, if applicable, that is not inconsistent with the trajectory in the Commonwealth Fiscal Plan, by completing the template provided. As outlined in the template, the schedule should include a comparison of revenues and expenditures to the prior two budgets (FY17 and FY18) and to the prior two years of draft unaudited actuals (FY16 and FY17). Report if there are no revenues and/or expenses this year.		Outstanding	Incomplete submission
13	Provide all items above, where applicable (i.e. numerical inputs and outputs), in a letter sized print friendly excel format.		Outstanding	Incomplete submission