



**BANCO DE DESARROLLO  
ECONOMICO  
PARA PUERTO RICO**  
GOBIERNO DE PUERTO RICO

*KPMG AUDIT  
CORRECTIVE ACTION PLAN  
JUNE 30, 2010*

<u>Finding</u>	<u>Recommendation</u>	<u>Management</u>	<u>Action</u>	<u>Estimated Completed Date</u>
<p><u>Allowance for Loan Losses- Credit files and Appraisals</u></p> <p>During our review of the allowance for loan losses calculation, we noted that many loan files of the individual cases examined and used for the specific allowance for loan losses calculation did not include recent relevant financial information and appraisals. The specific allowance calculation for impaired loans is often based on a discounted cash flow analysis based on either operating cash flow information or the fair value of underlying collateral. The collateral values used are generally based on the initial appraisal performed when the loan was originated. The lack of current financial information and current property values could cause misstatements in the allowance.</p>	<p>We recommend management to maintain updated loan files with current financial information to evaluate borrower's financial position and to document in the loan files visits and periodic evaluations performed on the property values to update the analysis on collateral dependent loans as per Accounting Standards Codification (ASC) 310-10-35-35 requirements (previously referred as Statement of Financial Accounting Standards (SFAS) No. 114)</p>	<p><u>Jorge Crespo</u> <u>VPE Area de Riesgo y Cumplimiento</u> <u>Ivonne Otero,</u> <u>Presidenta</u></p>	<p>Collateral dependent loans are managed by the Special Loan Unit and once transferred the process calls for visits to debtor, inspection of collateral and an internal current valuation to determinate deficiencies which are immediately reserved. In addition, during the second semester of 2010, we started a current valuation project covering collateral properties. First stage for the Asset disposition ones and the second stage during the first semester of 2011 for the Special Loan Unit ones</p>	<p>Done</p>



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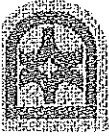
<u>Finding</u>	<u>Recommendation</u>	<u>Management</u>	<u>Action</u>	<u>Estimated Completed Date</u>
<p><u>Allowance for Loan Losses- Charge-Offs</u></p> <p>During our review over the implementation of the new charge-off policy, we noted that the loan portfolio at June 30, 2010 contained \$2.8 million fully reserved loans, which should have been charge off. The bank did not timely charge off the excess of loan value above the estimated collateral value on loans over 180 days past due, as requires by the recently adopted policy.</p>	<p>Timely recording of charge-offs would allow the bank to build up precise statistics with regards to the charge-off trends, which would later be useful to build models and analyze portfolio performance.</p>	<p><u>Jorge Crespo</u> <u>VPE Riesgo y Cumplimiento</u> <u>Lizzie Rosso</u> <u>Presidenta</u></p>	<p>All identified loans totaling \$2,502,909.52 were charge-off during August 2010. Thereafter, the Bank has been processing corresponding write-offs as per adopted policy.</p>	<p>Done</p>



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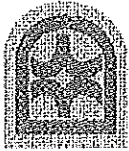
<u>Finding</u>	<u>Recommendation</u>	<u>Management</u>	<u>Action</u>	<u>Estimated Completed Date</u>
<p><u>Allowance for Loan Losses- Unallocated Reserve Documentation</u></p> <p>During our review of the unallocated component of the allowances for loan losses, we noted that there is no support for the algorithm used to compute the unallocated reserve</p>	<p>The unallocated reserve should reflect the qualitative and environmental characteristics of the institution's loan portfolio and rationale behind the policy selection should be properly documented.</p>	<p><u>Samuel Carlo Contralor</u> <u>Ivonne Otero Presidenta</u></p>	<p>A change to the Loan Loss Reserve Policy is been prepared in order to eliminate the unallocated reserve.</p>	<p>Done</p>
<p><u>Internal Control Considerations over the federal economic Development Administration Program (EDA)-Internal control over Reporting</u></p> <p>Currently, there is no documented review control to reduce the possibility of errors in the EDA semiannual reporting requirements.</p>	<p>The Control structure can be strengthened if the reporting requirements currently submitted by the Controller are prepared by another resource and reviewed by the Controller.</p>	<p><u>Samuel Carlo Contralor</u> <u>Ivonne Otero Presidenta</u></p>	<p>The EDA semiannual report will be prepared by the Controller and reviewed by the VPE Finance and Operation.</p>	<p>Done</p>



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<p><u>Internal Control Considerations over the federal economic Development Administration Program (EDA)- Internal control over Activities - Unallowed loans</u></p> <p>The Compliance Supplement lists the unallowed loans for which the bank might approve EDA funds to its lenders.</p>	<p>Even though we did not notice any instance of noncompliance with unallowed activities, the implementation of a checklist that lists the unallowed loans will add a visual control that will help to ensure that loans processed under EDA program are not listed as part of the unallowed activities on the Compliance Supplement. We noted that personnel are knowledgeable of the requirements; however, the control structure can be strengthened to ensure that the Bank is not dependent only on the knowledge of its current officials.</p>	<p><u>Ildfonso Rodríguez Troche,</u> <u>VPE Crédito</u> <u>Ivonne Otero,</u> <u>Presidenta</u></p>	<p>Esta acción correctiva se realizó el 17 de marzo de 2011. Se incluye Anejo EDA LOAN'S REQUIREMENTS. La misma fue aprobada por el Sr. Ildfonso Rodríguez, VPE Area de Crédito y del 1 de abril de 2011 Presidente Interino. También se preparará un seminario que se distribuirá por Intranet a todo el personal del Banco, referente a los requisitos de EDA. E-mail 11 de abril de 2011, a todo el personal.</p>	<p>Done</p>



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<p><u>Other Real Estate Owned</u></p> <p>During our review of the Other Real Estate Owned, we noted that certain properties did not have a recent appraisal report, and in some cases, there were no appraisals at all. Due to the current stagnant economy, and slow real estate market, we understand that the value of certain real estate properties might have declined during the course of the past two years. The current tendency in the market has been of disposition below appraised values</p>	<p>We recommend that the Bank develop and implement a formal policy to help ensure that repossessed properties are properly recognized taking into consideration depression in external economic and market factors. This could be achieved by maintaining updated appraisal reports related to the inventory of properties on hand.</p>	<p><u>Maritza Fuster</u> <u>Supervisora</u> <u>División</u> <u>Administración de</u> <u>Propiedades</u></p> <p><u>Ivonne Otero</u> <u>Presidenta</u></p>	<p>Administración de Propiedades comenzó por retasar todas las propiedades que no tenían tasación y tasaciones con más de 4 años. Se solicitó presupuesto de estar el presupuesto y tener contratos con tasadores disponible, se realizarán las mismas. Las tasaciones incluirán valor en el mercado y "liquidation value". Siempre se ha informado a la Gerencia que aquellas propiedades que presenten problemas y no puedan ser vendidas hasta la solución de los mismos, Administración de Propiedades anteriormente ha recomendado no tasar (no invertir dinero en tasar) hasta resolver los mismos y tasar cuando estén en condiciones para la venta.</p>	<p>Done</p>



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<p><u>Venture Capital External Investment Pools</u></p> <p>Under Financial Accounting standards Board (FASB) Accounting Standards Update No 09-012, Investments in Certain Entities that Calculate Net Asset Value per Share or Its Equivalent (ASU 09-12), investors may use net asset value to estimate the fair value of investment companies that do not have a readily determinable fair value if the investees have the attributes of investment companies and the net asset values or their equivalents are measured at fair value. This would be the case for the Venture Capital External Investment pools that the Bank is currently holding. Under ASU 09-12, if the investee's reporting date is different from the investor's, the investor would be allowed to use the practical expedient based on the latest audited net asset value reported by the investee. However, ASU 09-12 requires the investors to adjust for significant events that have occurred since the date the investee reported its audited net asset value. We noted</p>	<p>Given the current environment under which local companies are operating, and given the requirements of ASU 09-12, we recommend the Bank to strengthen its documentation supporting adjustments made to the Venture Capital External Investment pools as of June 30</p>	<p><u>Jorge Negron</u> <u>Gerente</u> <u>EDBCI</u></p> <p><u>Lizzie Rosso</u> <u>Presidenta</u></p>	<p>Upon the receipt of the quarterly non-audited reports, additional questions will be posted to the General Partners as necessary.</p>	<p>Quarterly upon receipt of reports</p>



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that the Bank adjust net asset values as per the interim values reported by the Venture capital External Investment pools. Additional procedures might need to be implemented in order to validate unaudited interim values reported by the Venture capital External Investment Pools.				

Preparado por:

Fecha: 17 - febrero - 2011

Revisado por:

Fecha: 2/17/11