BANCO DE DESARROLLO ECONÓMICO PARA PUERTO RICO
GOBIERNO DE PUERTO RICO

KPMG AUDIT
CORRECTIVE ACTION PLAN
JUNE 30, 2011

Finding	Recommendation	Management	Action	Estimated Completed Date
Allowance for Loan Losses and Charge Offs During the year ended June 30, 2011, the Bank updated its computation methodology for the allowance for loan losses under the Accounting Standards Codification (ASC) 450-10-05-05 (previously referred as Statement of Financial Accounting Standards (SFAS) No.5) using historical loan loss factors derived from the historical charge-offs trend, adjusted by some environmental factors. Since this new policy requires timely charge offs to ensure accuracy of the historical loan loss factors, the Bank also implemented new procedures to timely charge off of loans. According to Policy Number BDE-007-PE-Proc.002 Section IX, the excess of loan value above the estimated collateral value on loans over 180 days past due shall be charged against the reserve. Notwithstanding, at June 30, 2011, the loan portfolio contained approximately $6.7MM, which was not in compliance with this policy. Amounts for each loan had been specifically reserved: however, charge offs had not taken place.	Management should further review procedures in place to either ensure that Policy is followed, or modify the policy to allow for a defined period of time to complete charge off procedures. Timely recording of charge-offs would allow the Bank to build up precise information with regards to the charge-off trend, and the development of loan loss factors for the general reserve.	**Jorge Crespo** **VPE Riesgo y Cumplimiento** **Ivonne Otero** **Presidenta**	A risk analysis for active loans exceeding net principal balance of $200K is prepared at least every six (6) months. Once the risk analysis is reviewed and signed by the officer in charge of the account and his (her) Supervisor, a copy of it is referred to the attention of the person responsible for verifying the Bank's reserve at the Finance Division, Mrs. Ivette Rivera. Finance Division then acknowledges receipt of the risk analysis and identifies any difference within the risk analysis as the check and balance in the process. Afterwards, copies of aforementioned risk analysis are referred to the Risk and Compliance EVP for final approval. Once the risk analysis is approved by the EVP, it is posted in our institution's intranet under the Special Loans and Recovery Area at the shared documents section. This process has been taken place since November, 2011. Also, as part of said	Completed

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			risk analysis, collateral value is reviewed and any deficiency is either reserved or written off on or before 60 days after the delinquency report reflects that loan is over 120 DPD (for unsecured loans) or 180 DPD (for partially secured loans). Section IX of our procedure was amended on December 6, 2011 to reflect previously mentioned time limit. See Exhibit 1. Further, Bank is now processing write offs on a monthly basis instead of in a quarterly basis. A list of the loans to be either partially or fully written off shall be submitted by months to Bank's Analytical Intelligence Administrator, Mrs. Lucy Sánchez on or before the 15th day of such month.	

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Venture Capital External Investment Pools 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 that the Bank adjust net asset values as per the interim values reported by the Venture capital	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 the value of venture capital external investment pools, which are valued at different dates than the latest audited financial statement information.	**Jorge Negron** **Gerente** **EDBCI** **Ivonne Otero** **Presidenta**	For the venture capital external investment pools, the following steps are in the process of being implemented: 1. Request the quarterly reports (the fund managers already send them, but reminders are anyways sent). 2. Once received, the information for the different companies is to be input in a spreadsheet, which shows the development of the valuation of the company through time. 3. Some variation on the valuation of companies is expected, given the directions of FASB standards. However, if the variation is markedly below or above the previous period, then additional information may be required from the fund manager. 4. The additional information is evaluated. 5. Since the valuation methods of each fund manager have been sanctioned by their respective auditors, there would need to be an obvious reason to modify the valuation provided by the fund manager, which would be internally discussed.	Completed

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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. During our audits, the Bank had not documented or supported their evaluation of certain material investments that suffered significant events, which might have affected its value.				
Allowance for Loan Losses Documentation – Credit Files and Appraisals Our review of the allowance for loan losses calculation disclosed many loan files of the individual cases examined and used for the specific allowance for loan losses calculation that did not include recent relevant financial information and/or 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	In order to ensure a accurate application of the allowance for loan losses for collateral dependent loans, as per the Accounting Standards Codification (ASC) 310-10-35-35 requirements (previously referred as SFAS No. 114), we recommend management to maintain updated loan files with current financial information to evaluate the borrower's financial position, to	**Jorge Crespo VPE Riesgo y Cumplimiento** **Ivonne Otero Presidenta**	Management developed Guides for the Evaluation of collateral for Cases on special Loans dated November 1, 2011, BDE-007-PE-Guía.01 (the "Guides"). Such Guides were included as part of the collections procedure. Aforementioned guides establish liquidation value criteria to be used under various scenarios. On the other hand, most of our cases do not have recent financial information available either because debtor has not provided it or has not prepared them since business is no longer in operation.	Completed

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was originated. Lack of current financial information and current property values could cause misstatement in the allowance. During our review, we noted that on some cases the information used related to collaterals was not in agreement with the data available to the Credit Department, hence impairing management's ability to make an accurate analysis of the allowance. Also KPMG noted that management used 35% for all machinery collateral as a common practice, without taking in consideration if an appraisal was available.	strengthen controls to ensure that the Accounting Department and the Credit Department use the same borrowers data to perform a consistent evaluation of the reserve estimate, and to align its procedures to established polices.		Therefore, most of our risk assessment analysis is based on collateral liquidation (impaired loans) values. The Bank periodically requires new appraisal reports for certain properties. Due to budgetary limitations, not all properties can be appraised at once. Further, every six (6) months we prepare an updated risk analysis including recent appraisal or liquidation value percentages based on the Guides.	

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Other Real Estate Owned During our review of Other Real Estate Owned, many properties did not have a recent appraisal report and in some cases, there was no appraisal information available. 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 four years. The current tendency in the market has been dispositions below appraised values.	We recommend that the Bank develop and implement a formal policy to help ensure that repossessed properties are properly recognized taking into consideration external economic and market factors. This could be achieved by maintaining updated appraisal reports related to the inventory of properties on hand.	**Gabriel Gil** **VPE Finanzas y Operaciones** **Ivonne Otero** **Presidenta**	The EDB is carrying out a plan to appraise all Other Real Estate Owned with liquidation value, prioritizing on those with a higher risk of loss based on acquisition value and date of available appraisals. In addition, in order to further mitigate the risk of loss, the reserve of properties not recently appraised is being set to at least 30% of appraised value. EDB is striving to maintain updated appraisal reports for repossessed properties, as well as precise valuation of these in the financial statements.	Completed