

**U.S. Department of the Interior  
Office of Inspector General**

# **Audit Report**

## **Loan Programs Guam Economic Development Authority Government of Guam**



**Report No. 01-I-417  
September 2001**



## United States Department of the Interior

### OFFICE OF INSPECTOR GENERAL

Pacific Field Office  
415 Chalan San Antonio  
Baltej Pavilion, Suite 306  
Tamuning, Guam 96911

September 21, 2001

Mr. Chris Murphy  
Chairman, Board of Directors  
Guam Economic Development Authority  
ITC Building, Suite 511  
590 South Marine Drive  
Tamuning, Guam 96911

Subject: Audit Report on Loan Programs, Guam Economic Development Authority,  
Government of Guam (Report No. 01-I-417)

Dear Mr. Murphy:

This report presents the results of our audit of loan programs at the Guam Economic Development Authority.

Please provide a response to this report by October 22, 2001. The response should provide the information requested in Appendix 6 and should be addressed to our Pacific Field Office, 415 Chalan San Antonio, Baltej Pavilion - Suite 306, Tamuning, Guam 96911.

Section 5(a) of the Inspector General Act (5 U.S.C. app. 3) requires the Office of Inspector General to list this report in its semiannual report to the U.S. Congress. In addition, the Office of Inspector General provides audit reports to the Congress.

Sincerely,

Arnold E. van Beverhoudt, Jr.  
Audit Manager for Insular Areas

cc: Honorable Carl T.C. Gutierrez, Governor of Guam



## **EXECUTIVE SUMMARY**

**Loan Programs,  
Guam Economic Development Authority,  
Government of Guam  
Report No. 01-I-417  
September 2001**

The Guam Economic Development Authority was established in August 1965 to assist in the implementation of an integrated program for the economic development of Guam. The Authority administered five business loan programs that, as of September 30, 1999, had a total of 155 outstanding loans totaling more than \$13 million in principal, interest, and fees/charges. The two larger loan programs were the Guam Development Fund, with 87 outstanding loans totaling \$11.7 million, and the Agriculture Development Fund, with 39 outstanding loans totaling \$1.1 million.

The objective of our audit was to determine whether the Authority (1) effectively administered the loan programs and (2) achieved the objectives for which the programs were established. The scope of the audit include a review of loans issued by the Guam Development Fund and the Agriculture Development Fund during fiscal years 1986 through 1999.

We found that there was a need for improvements in the Authority's loan program operations, lending practices, and collection enforcement practices. Specifically, the Authority:

- 9 Used \$1.34 million from the Guam Development Loan Program to cover the bad debt cost of writing off uncollectible loans and transferred profits of \$1.33 million from the sale of property recovered on a delinquent loan to its own operating fund. These actions were contrary to legislation establishing the Loan Program and the approved Program Plan.
- 9 Lost Loan Program funds estimated at \$453,653 and placed additional Loan Program funds of about \$3.6 million at risk of loss because it made loans from the Development Loan Program to a wholly owned subsidiary corporation and to businesses that had existing delinquent Program loans or Authority leases. Furthermore, because an arm's-length relationship did not exist between the Authority and its subsidiary, the normal checks and balances inherent in making loans to unrelated borrowers did not exist.
- 9 May have lost \$2.3 million in delinquent loans and placed another \$2.2 million in delinquent loans at risk of loss and lost at least \$303,697 and placed another \$784,000 at risk because of the declining value of foreclosed real property and because the Authority did not effectively approve loans and collect delinquent loans. The Authority did not (1) require that

problem borrowers be referred for management assistance, (2) ensure that its attorneys took timely action to protect the Authority's interests in loan collateral, and (3) sell repossessed real property in a timely manner.

We made 10 recommendations to the Chairman of the Authority's Board of Directors to stop charging losses related to delinquent loans to the Development Loan Program and develop alternative methods of safeguarding itself against losses from delinquent loans, institute organizational and procedural changes to ensure that an arm's-length relationship exists between the Authority and its wholly owned subsidiary with regard to lending practices, and implement procedures to improve the effectiveness of loan collection practices.

#### **AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL EVALUATION**

The Authority concurred with 2 of the report's 10 recommendations and expressed nonconcurrence with the other 8 recommendations. Based on the response, we considered eight recommendations unresolved and requested additional information for two recommendations.

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# INTRODUCTION

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## BACKGROUND

The Guam Economic Development Authority was established in August 1965 as a public corporation "to assist in the implementation of an integrated program for the economic development of Guam" and "to be a catalyst in the economic development" of Guam by "aiding private enterprise without unfairly competing with it." The Authority is authorized to provide loans, issue revenue bonds, purchase mortgages, recommend to the Governor of Guam the granting of tax rebates and abatements to qualifying businesses, and function as the Government's financial advisor and manager of industrial park leases. In addition, the Authority used various trust funds to operate five loan programs.

The five active loan programs administered by the Authority were (1) the Guam Development Fund, (2) the Agriculture Development Fund, (3) the Microenterprise Development Fund, (4) the GEDA (Guam Economic Development Authority) Loan Fund, and (5) the Local Arts Revolving Fund. As of September 30, 1999, the five loan programs had a total of 155 outstanding loans totaling more than \$13 million in principal, interest, and fees/charges (see Appendix 2). The two larger loan programs were as follows:

- The Guam Development Fund was the trust fund used to account for the Authority's largest loan program, the Development Loan Program, which was created through Federal legislation on October 17, 1968. According to 48 U.S.C. § 1428a, the Loan Program "shall include and make provision for loans and loan guarantees to promote the development of private enterprise and private industry in Guam through a revolving fund for such purposes." The U.S. Government provided a total of \$6.7 million to fund the Program. Also, 48 U.S.C. § 1428a required the Government of Guam, before it received any funds, to prepare for the approval of the Secretary of the Department of Interior "a plan for the use of such funds," which the Secretary approved.<sup>1</sup> After the Development Loan Program was created, the Government of Guam contributed \$100,000 to the Program's assets. As of September 30, 1999, the Loan Program had 87 outstanding loans<sup>2</sup> totaling \$11.7 million in principal, interest, and fees/charges.

- Through the Guam Code Annotated (12 G.C.A. § 52101 and 52103), the Government of Guam created the Agriculture Development Fund in 1988 "to aid in the development or subsidization of poultry, pork, and beef production, agricultural products, processing plants and equipment loans. This development will be wholly on the basis of a private enterprise." Further, 12 G.C.A. § 52106.1 stated that the Authority "shall make direct loans to and guarantee loans of responsible non-profit cooperative associations and individual farmers necessary for expanding facilities for the improvement of marketing of agricultural products and other related agricultural activities." As of September 30, 1999, the Agriculture

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<sup>1</sup>Although we could not locate the original letter approving the Plan, we did locate a June 25, 1975 letter from the Secretary of Interior to the Governor of Guam that approved an amendment to the Plan.

<sup>2</sup>This number excludes three guaranteed loans totaling almost \$2 million that were issued by private lenders.



Development Fund had 39 outstanding loans totaling almost \$1.1 million in principal, interest, and fees/charges.

## **OBJECTIVE AND SCOPE**

The objective of the audit was to determine whether the Guam Economic Development Authority (1) effectively administered the development loan programs and (2) achieved the objectives for which the programs were established. The original scope of the audit included a review of loans issued by the Guam Development Fund and Agriculture Development Fund loan programs during fiscal years 1996 through 1999. We subsequently expanded the audit scope to include the Authority's administration of the Development Loan Program for fiscal years 1986 through 1996 to include the years subsequent to the period covered in our March 1988 audit report on the Development Loan Program (No. 88-53). This is the first of three reports we plan to issue on the Authority's operations. The other reports will cover (1) industrial development programs and (2) bonds, leases, and financial activities.

To obtain information on the processing, administration, and collection of loans, we interviewed officials and/or reviewed records at the offices of the Guam Economic Development Authority, the Authority's independent public accounting firm, and the Guam Office of the U.S. Small Business Administration. We also corresponded with an independent public accountant previously contracted by the Authority and obtained a legal opinion from our General Counsel (see Appendix 4).

Our review was made, as applicable, in accordance with the "Government Auditing Standards," issued by the Comptroller General of the United States. Accordingly, we included such tests of records and other auditing procedures that were considered necessary under the circumstances.

As part of the audit, we evaluated the system of internal controls related to the financial and operational management of the Guam Economic Development Authority loan programs to the extent that we considered necessary to accomplish the audit objective. Based on our review, we determined that the Authority generally achieved the loan programs' objectives. However, we identified internal control weaknesses in the areas of loan program operations, lending practices, and delinquent loan collections. These weaknesses are discussed in the Findings and Recommendations section of this report. Our recommendations, if implemented, should improve the internal controls in these areas.

## **PRIOR AUDIT COVERAGE**

During the past 5 years, neither the U.S. General Accounting Office nor the Office of Inspector General has issued any audit reports on the Guam Economic Development Authority. However, in March 1988, the Office of Inspector General issued the audit report "Guam Economic Development Authority's Administration of the Revolving Loan Fund" (No. 88-53). The report stated that deficiencies related to the Development Loan Program resulted in unauthorized loan expenditures totaling \$1.8 million and delinquent loans totaling \$6.7 million, of which \$3.4 million was considered uncollectible. The report contained

17 recommendations, and based on our current review, we determined that 4 recommendations had been implemented and 13 recommendations had not been implemented.

## **FINDINGS AND RECOMMENDATIONS**

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### **A. LOAN PROGRAM OPERATIONS**

The Guam Economic Development Authority used \$1.34 million from the Guam Development Loan Program to cover the bad debt cost of writing off uncollectible loans and transferred profits of \$1.33 million from the sale of property recovered on a delinquent loan to its own operating fund. These actions were contrary to legislation establishing the Loan Program and the approved Program Plan. The Authority's Administrator stated that the Authority did not have adequate financial resources to absorb the costs of writing off uncollectible Loan Program loans and that the Authority based its actions on legal opinions which stated that payment of these expenses and transfers of profits were appropriate.

#### **Legal Opinions Concerning Uncollectible Loans**

The Office of the Solicitor, U.S. Department of Interior, issued two legal opinions, dated August 7, 1969 and May 21, 1987, which stated that the use of loan funds for administrative and write-off costs was not allowed under the Loan Program. The opinions were issued based on inquiries from the Government of Guam about the use of Program funds. On February 18, 1988, the Authority obtained a legal opinion from its attorney, which stated that payments of administrative and uncollectible loan costs were authorized uses of the funds. The Authority obtained its legal opinion in response to the draft of our March 1988 audit report (No. 88-53) and, based on the legal opinion, did not implement the report's recommendation to discontinue the practice of charging the Loan Program for uncollectible loan expenses. However, the Authority had no record that it had informed the Office of Insular Affairs of the opposing legal opinion.

Because the Authority's legal opinion contradicted the two prior opinions from the Department of the Interior's Solicitor, we requested that our General Counsel review all three opinions to assist us in determining (1) the authorized uses of Loan Program funds and (2) whether alternatives were available for the Authority to recover some or all of its administrative and uncollectible loan costs relating to the Loan Program.

On August 18, 2000, the General Counsel, Office of Inspector General, issued a legal opinion (Appendix 4) on these issues, which stated, "The Authority can use the Fund's interest or the principle to recover the administrative costs of operating the loan program. The Authority [however] cannot use the Fund's interest or the principle for uncollectible loan costs."

We found that during the period of September 1993 to September 1999, the Authority wrote off, against Loan Program revenues, 11 uncollectible loans totaling about \$1.34 million. However, as noted in our March 1988 report, the Federal law and the Federally approved Plan establishing the Loan Program provide a possible alternative for the Authority to recover uncollectible loan costs. Specifically, 48 U.S.C. §1428a states that loans from the Program "shall bear interest (exclusive of premium charges for insurance, and service charges, if any) at such rate per annum as is determined to be reasonable and as approved by the Secretary . . . and that premium charges for the insurance and guarantee of loans shall be commensurate . . . with expenses and risks covered." In our opinion, this section of the legislation clearly

contemplates that losses related to uncollectible loans would be recovered through loan insurance or guarantees paid for by borrowers. This opinion is supported by the August 2000 legal opinion from our General Counsel. Therefore, the Authority should reexamine the option of charging loan insurance fees, which would allow the Authority to obtain loan insurance to protect itself against losses related to uncollectible loans.

## **Property Settlement Payment**

Neither the authorizing legislation nor the approved Plan provided specific guidance on the disposal of property acquired by the Authority through foreclosures. In a January 27, 1989 interoffice memorandum, the Authority's Financial Assistance Officer notified the Administrator that after extensive litigation, the Authority had received a payment of \$2,199,995 as recovery on a delinquent loan. The Officer stated in the memorandum that after applying costs totaling \$840,707 to pay off the loan balance of \$500,000 plus accrued interest, attorneys' fees, and related costs, the Authority was left with a "GDFA GAIN"<sup>3</sup> of \$1,359,288. However, according to the minutes of a February 8, 1989 regular meeting of the Authority's Board of Directors, the Board "passed without objection" Resolution No. 89-006, which required that "any excess" of sales proceeds above the amount of principal, accrued interest, costs, and attorney fees "be deposited into GEDA's general fund account." This action was taken based on the legal opinion of the Authority's attorney and despite the Financial Assistance Officer's memorandum stating that the \$1.36 million should be deposited into the Loan Program account. The Authority's fiscal year 1989 audited financial statements reported that during fiscal year 1989, a total of \$1,327,503<sup>4</sup> was transferred to the Authority's General Operating Fund. Because the funds were not deposited to the Loan Program Revolving Fund, the \$1.33 million was not available for future loans, which was the purpose of the Program.

## **Recommendations**

We recommend that the Chairman of the Board of Directors, Guam Economic Development Authority, direct the Authority's Administrator to:

1. Discontinue the practice of charging the Development Loan Program for the loss resulting from uncollectible loans.
2. Provide the Office of Insular Affairs, U.S. Department of the Interior, with documentation related to the \$1.34 million charged to the Development Loan Program for uncollectible loans and for the \$1.33 million from property settlements for its determination as to whether the funds should be reimbursed to the Development Loan Program.
3. Perform an analysis comparing the Development Loan Program with current Federal loan programs in order to evaluate options for structuring the Loan Program to allow the

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<sup>3</sup>"GDFA" referred to "Guam Development Fund Act," which was the title the Authority gave to the Federally financed Guam Development Loan Program revolving loan fund.

<sup>4</sup>Because accounting records for fiscal year 1989 were no longer available, we could not determine why \$31,785 less than the \$1,359,288 was transferred to the General Operating Fund.

Authority to recover reasonable loan insurance costs. Based on such an analysis, a revised Loan Program Plan should be submitted to the Office of Insular Affairs, U.S. Department of the Interior, for review prior to submission to the Secretary of the Interior for approval.

## **Guam Economic Development Authority Response and Office of Inspector General Reply**

In the May 21, 2001 response (Appendix 5) to the draft report from the Authority's Chairman of the Board, the Authority expressed nonconcurrence with Recommendations 1 and 2 and concurrence with Recommendation 3. Based on the response, we consider Recommendations 1 and 2 unresolved and request additional information for Recommendation 3 (see Appendix 6).

### **Recommendation 1. Nonconcurrence.**

**Guam Economic Development Authority Response.** The Authority stated that it chose not to obtain loan loss insurance because of the high cost to the borrowers and that its Chief Financial Officer has been assigned "to evaluate the creation of a loan loss reserve account to off set future losses, utilizing a portion of the interest earned on the [Guam Development Fund] loans."

**Office of Inspector General Reply.** By its nature, the Loan Program Revolving Fund should not be charged for uncollectible loans because the Fund would otherwise eventually be depleted. Our General Counsel's opinion emphasized that the Authority cannot legally use the Fund's principal or interest to recover the cost of uncollectible loans. Therefore, the use of a portion of interest earned on the Development Fund loans to set up a loan loss reserve account also would not be acceptable. The Authority must seek other legal alternatives to recovering the losses from uncollectible loans and not charge such losses to the Development Loan Program. The Guam Development Fund Act enabled the Authority to find alternatives for recovering uncollectible loans, such as premium costs, collateral, or insurance. Although the Authority resists implementing a loan insurance program because of cost considerations, it should recognize that the beneficiaries were granted their loans under less stringent requirements after having been turned down by more traditional lending institutions. Accordingly, it is not unreasonable for the cost of loan insurance to be borne by all of the beneficiaries of the Loan Program, namely the borrowers.

### **Recommendation 2. Nonconcurrence.**

**Guam Economic Development Authority Response.** The Authority stated, "GEDA is able to provide the requested documentation on the \$1.34 million in loans that were charged off and the \$1.33 million gain from a property settlement. However, GEDA does not concur that it should reimburse the fund for the deficiency balances on the loans that were written off and for the gain received under the property settlement cited in the audit report." The Authority also stated that "if the [delinquent] accounts had stopped accruing interest once the account was classified as 'in default' then the unpaid balances would most likely have been recovered through GEDA's collection efforts over a nearly fifteen year time span." The Authority also detailed the sequence of events related to the \$1.33 million gain from property

settlement and concluded that the audit report "fails to identify any legal basis of why a lender would not be entitled to receive any amount in excess of the original principal, interest, and related expenses."

**Office of Inspector General Reply.** Regarding the charged-off loans of \$1.34 million, the Authority has not provided any documentation to support that collection efforts were made and were successful in recovering the defaulted amounts. The General Counsel's opinion is clear that losses from uncollectible loans may not be charged against the Development Loan Fund. Therefore, we believe that the \$1.34 million should be reimbursed to the Fund. Regarding the \$1.33 million gain from property settlement, the Authority's response indicates that at least \$2.6 million from the Development Loan Fund was used in the Authority's efforts to redeem the property that secured the defaulted loan. We believe that, to the extent that recoveries were made, such recoveries should have been used to reimburse the Fund for both the principal and interest owed on the loan and the \$2.6 million used during the property settlement efforts. Lastly, the recommendation does not require the Authority to immediately reimburse the Fund for the loan write-offs or the property settlement gain. Rather, the recommendation simply asks the Authority to provide information to the Office of Insular Affairs for a final determination as to whether the money should be reimbursed to the Development Loan Program.

### **Recommendation 3. Concurrence.**

**Guam Economic Development Authority Response.** The Authority stated that it recognizes that "there may be a need for GEDA to re-evaluate the [Development Loan Program] to meet the island business community's current financial needs." The Authority further stated that its Financial Services Supervisor will be responsible for developing a strategic plan that includes such an evaluation.

**Office of Inspector General Reply.** The response did not specifically state that options for structuring the Loan Program to allow the Authority to recover reasonable loan insurance costs would be included in the proposed Strategic Plan.

## **B. LENDING PRACTICES**

The Guam Economic Development Authority lost Loan Program funds estimated at \$453,653 and placed additional Loan Program funds of about \$3.6 million at risk of loss because it made loans from the Development Loan Program to a wholly owned subsidiary corporation and to businesses that had existing delinquent Program loans or Authority leases. This occurred because the Authority did not have written policies or procedures adequate to ensure that loans to subsidiaries or to delinquent borrowers and lessees were subject to a strict evaluation and approval by an Authority official of the borrowers' ability to repay the loans. Furthermore, since an arm's-length relationship did not exist between the Authority and its subsidiary, the normal checks and balances inherent in making loans to unrelated borrowers did not exist.

### **Guam Business Development Corporation Loans**

The Authority created the Guam Business Development Corporation on August 28, 1991 (see Appendix 3). Regarding the establishment of the Corporation, the minutes of an April 13, 1995 Board of Directors meeting state:

Counsel recommended that GBDC (Guam Business Development Corporation) go forward and get organized as the Governor is going to give GEDA some very heavy responsibilities in the immediate future which are going to require GBDC's assistance. The chairman noted that the operation of GBDC would give GEDA a valuable tool as well as more flexibility in its operations. Counsel pointed out that GBDC can purchase supplies for GEDA without going through the Procurement Law, and can be useful in other areas where governmental regulations might otherwise interfere.

On July 13, 1995, the Authority's Board of Directors adopted Resolution No. 95-013, which stated, "3. Independence from governmental restrictions. That as a private corporation, GBDC not be constrained by government of Guam statutes, rules or regulations applicable to instrumentalities of the government of Guam."

Through September 1999, the Authority authorized three Program loans to the Corporation: two loans totaling \$1.4 million to buy land and build a warehouse as a manufacturing facility for a locally based business and the third loan totaling \$1.2 million to pay for towing a large surplus U.S. Navy floating dry dock from Hawaii to Guam. As of September 30, 1999, the total amount drawn down and outstanding on the three loans was \$2.1 million. The \$2.6 million originally loaned to the Corporation was 38.8 percent of the \$6.7 million Federal Government contribution to the Loan Program. Under the conditions of the Federal contributions (48 U.S.C. § 1428b), funding for any single project was limited to 25 percent of the Federal contributions.

We noted that the Authority did not maintain an arm's-length relationship with the Corporation. For example, the Authority (1) issued two of the three loans to the Corporation at the lowest interest rate allowable under the Loan Program's authorizing legislation; (2) did not charge loan fees on the third loan, as was required from other borrowers; (3) did not require that the Corporation have three bank declinations before applying for a Program loan, as required by the Authority's Standard Operating Procedures; and (4) made loans without

Corporation-generated revenues being available to repay the loans. Additionally, the Board of Directors of the Authority and the Corporation were composed of the same individuals, and this precluded an independent assessment of the Corporation's loan applications. Considering the weak financial positions of the Corporation, the Authority, and the Government of Guam,<sup>5</sup> we believe that outstanding loans totaling almost \$2.1 million as of September 30, 1999 were at risk of loss.

**Loans on Behalf of Manufacturing Company.** On December 30, 1991, the Authority loaned the Corporation a total of \$675,000 to purchase a 3/4 acre lot for about \$330,000 and build a warehouse estimated to cost \$345,000 for the use of a specific manufacturing company that had an outstanding Authority loan at the time. The Corporation planned to repay the loan with the manufacturing company's warehouse rental payments. At the February 23, 1996 special meeting of the Corporation's Board of Directors (same Board members as the Authority's), the Board issued Resolution 96-001, which stated that "the building itself was designed specifically for [the company's] machinery and equipment, making it difficult to lease to any other party." The final costs to build the warehouse were about \$1.2 million, or almost \$900,000 more than the initial estimate. As a result, the Authority had to refinance the \$345,000 loan to pay for the increased construction costs. On January 28, 1994, the Authority approved a new \$1.4 million loan with a 25-year term at 4.5 percent interest per year. The Corporation had drawn down a total of \$1,229,302 by August 30, 1996. According to the promissory note, the Corporation did not have to make a principal payment on the loan until February 28, 1999.

When the project was completed in June 1996, project costs consisted of \$370,281 to buy about 1.2 acres of undeveloped land and \$1,207,031 to build a 10,416-square-foot warehouse (see Figure 1). However, the Corporation had insufficient revenues to make its first loan principal payments (due February 28, 1999) and subsequent principal payments to the Authority because the manufacturing company did not make the required payments on the lease and vacated the building in March 2000. On September 24, 1999, the Authority approved a resolution authorizing payments of interest only for 12 months on the Corporation's 1994 loan because the manufacturing company "is seriously in arrears of the rental payments, which payments were to be used to repay the debt incurred by GBDC." In addition, the Administrator said, "This action . . . will assist in easing the cash flow of GEDA under the dire financial situation that currently exists in Guam."<sup>6</sup> Finally, the Administrator told us that this was "a bad deal from the get go" and that he had "inherited a bad deal." A prior Administrator had the same concerns, as noted in the minutes of the Authority's October 9, 1991 Board of Directors meeting, which stated that a prior Administrator "was concerned that GEDA could be criticized for doing too much for the [manufacturing] company." As of September 30, 1999, the Corporation owed a total of \$1,196,202 (excluding interest) on this loan.

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<sup>5</sup>According to the single audit report for the Government of Guam for fiscal year 1998 (Report No. 00-A-195), the Government had a total fund equity unreserved deficit of \$262.9 million and a General Fund unreserved deficit of \$160.5 million as of September 30, 1998.

<sup>6</sup>As of September 30, 1999, the manufacturing company owed the Corporation delinquent lease payments of \$60,000 (for 12 months), and on November 12, 1999, the company filed for bankruptcy protection.





**Figure 1.** *This 10,416-square-foot warehouse, which was vacated by a manufacturing company in March 2000, was constructed with Loan Program funds of \$1.2 million. (Office of Inspector General photograph)*

**Loan to Tow Dry Dock.** On May 6, 1999, the Authority authorized a \$1.2 million line of credit to the Corporation from the Loan Program for a 2-year period at an annual interest rate of 5 percent. The purpose of the line of credit was to pay for the costs of moving a surplus U.S. Navy floating dry dock from Hawaii to Guam (see Figure 2).



**Figure 2.** *The Government of Guam dry dock that was towed from Hawaii at a cost of \$1.2 million and that has remained moored at the Guam Shipyard. (Office of Inspector General photograph)*

In an April 30, 1999 Board of Directors meeting, the Authority's Administrator recommended that "the interest on the loan be the average U.S. Treasury rate with no spread and no fees." According to the same Board minutes, the Administrator said that "the interest and principal [will] be paid at maturity, because GEDA feels confident that by the end of the year [1999], the drydock could be leased to the SRF [ship repair facility] operator and start repaying the loan." However, the Administrator subsequently told us that the anticipated time frame for use of the dry dock had not materialized because additional funds of up to \$4 million were needed to pay for necessary dry dock repairs at a construction facility outside Guam. In addition, after the repairs are completed, another \$1 million would be needed to move the dry dock to the State of Oregon to be certified before it could be used to start generating revenue.

The security for this \$1.2 million loan was questioned by the Authority's Programs and Compliance Officer 2 days before the line of credit was approved. In a memorandum to file dated April 28, 1999, the Compliance Officer stated:

I am however, concerned that this loan will be unsecured. . . . In order to secure GEDA's lien on this dry dock, the Mortgage would need to be executed by the Governor of Guam on behalf of the Government of Guam. Failure to so secure the lien would result in: 1) a \$1.2 million unsecured loan made from the Federal fund to GBDC; 2) no method to enforce repayment on the loan from the Gov't. of Guam from the income to be obtained by GovGuam from the lease of the dry dock; 3) lease income received can be easily diverted to the GovGuam General Fund.

As noted in the memorandum, the Government of Guam, not the Authority, owned the dry dock. Finally, according to the Authority's former Deputy Director, the dry dock cannot be sold because it was obtained without cost as U.S. Navy surplus, and the Government of Guam had to agree to conditions restricting its disposal because at least two other United States localities wanted the dry dock. As of September 30, 1999, the outstanding amount owed on this loan totaled \$895,161 (excluding interest) and had increased to \$984,703 by December 31, 1999, and the Government may have to spend about \$1 million to return the dry dock to the U.S. Navy in Hawaii.

In our opinion, the Authority used the Corporation to avoid having to comply with Development Loan Program requirements and, in effect, granted itself loans in non-arm's-length transactions despite the lack of adequate security and adequate revenues of the Corporation to repay the loans. Based on available financial statements from fiscal years 1992 through 1999, we estimated that during the 8-year period, the Corporation had earned \$229,000, spent \$1,310,000, and had an equity deficit of \$486,000. We do not believe that the loans made to the Corporation met the Program's requirements for prudent lending, limits on maximum loan amounts, prohibition of conflicts of interest, and adequate loan collateral.<sup>7</sup>

The Authority should provide detailed information about these loans to the Office of Insular Affairs for its determination of whether the Authority should reimburse the Loan Program the amount of the outstanding loans and stop making additional Program loans to the Corporation without verifiable sources of repayment and adequate security for the loan amounts.

## Loans to Delinquent Borrowers

The Authority made loans and/or released loan funds totaling over \$2.1 million for six loans to four borrowers, although the borrowers were delinquent in paying prior loans or, in one case, an existing lease with the Authority (see Table 1).

**Table 1. Questionable Subsequent Loans**

<u>Date of First Loan</u>	<u>Amount of First Loan</u>	<u>First Loan Status at Date of Next Loan</u>	<u>Date of Next Loan</u>	<u>Amount of Next Loan</u>	<u>Years Delinquent</u>	<u>Loan Funds Lost/At Risk</u>
08/07/91	\$1,600,000	No payments made	03/05/92	\$350,000	7.0	\$355,414
10/05/90	\$450,000	Delinquent 17 mos.	01/09/96	43,440	4.0	44,563*
10/05/90	Same Loan	Delinquent 19 mos.	03/08/96	43,440	4.0	49,495*
01/14/97	\$250,000	Delinquent 2 mos.	03/19/97	99,700	2.5	105,545
01/14/97	Same Loan	Delinquent 5 mos.	06/10/97**	1,200,000	1.1	1,236,164
08/30/82	Lease	Delinquent 12 mos.	08/31/97	<u>317,064</u>	1.5	<u>359,595*</u>
Totals				<u>\$2,053,644</u>	3.4 Avg.	<u>\$2,150,776</u>

\*Revenues lost on these three subsequent loans totaled \$453,653. Revenues considered at risk on the three loans not marked by asterisks totaled \$1,697,123. All amounts in this column include delinquent principal, interest, and service charges due as of September 30, 1999. We classified the loans as "lost" or "at risk" based on our assessment of the borrowers' ability to repay.

\*\*Although the loan agreement for the \$1.2 million loan was signed in December 1996, the Authority did not release the loan proceeds until June 10, 1997.

<sup>7</sup>The criteria for loans issued under the Development Loan Program are contained in the U.S. Code (48 U.S.C. § 1428b).

In accordance with its own operating procedures, the Authority should determine "that there is reasonable assurance of payment" of loans (GEDA's Standard Operating Procedures, Volume I, Chapter I, Paragraph 6.B(2)) and perform "a penetrating examination of the borrower's financial condition and repayment ability" (Volume I, Chapter V, Paragraph 19.I). However, as a result of the Authority's actions, Loan Program funds of at least \$453,653 had been lost, and additional Loan Program funds of at least \$1,697,123 were at risk of loss.

For example, in the largest of the subsequent loans listed in Table 1, the Authority approved a loan of \$1.2 million on December 20, 1996 but did not release the funds until June 10, 1997 because the borrower had not paid the loan closing fees of \$5,580. In a letter to the borrower dated June 9, 1997, the Authority's Administrator stated that the delay in issuing the loan had cost the Authority more than \$1,000 in lost interest and that if the closing costs were not paid by the following day, the loan commitment would be withdrawn. The delay in payment of the closing costs was significant because the business had also not made any payments on its two previous line-of-credit loans, one issued in January 1997 for \$250,000 and the other issued in March 1997 for \$99,700. As of September 30, 1999, the only amounts collected from this borrower on the three loans came from rental payments the Authority garnished from other assets of the borrower. These garnished payments were insufficient to pay even the interest on the \$1.2 million loan. According to the Authority's Administrator, the three loans were made because the prospects for the business looked very good in early 1997, before the Guam economy weakened, and the loan collateral was very good. We found no mention in the loan files of any actions taken by the Authority to reevaluate the additional proposed loans, to consider revising the loan terms, or to require that the two prior letter-of-credit loans be paid or at least be brought current before the \$1.2 million loan was released.

## **Recommendations**

We recommend that the Chairman of the Board of Directors, Guam Economic Development Authority, direct the Authority's Administrator to:

1. Require a written analysis and official certification by the Administrator of the ability of the Guam Business Development Corporation to repay any future loans or other advances of funds made from the Loan Program prior to making any such loans or advances.
2. Provide to the Office of Insular Affairs detailed information about the outstanding loans to the Guam Business Development Corporation for determination as to whether the Authority should reimburse the Development Loan Program the amount of the outstanding loans and stop making additional Program loans to the Corporation without verifiable sources of repayment and adequate security for the loan amounts.
3. Develop and implement policies and procedures to ensure that Authority personnel take prudent action, such as performing analyses of repayment ability and requiring that prior loans be brought current, to protect the Development Loan Program resources in instances when delinquent borrowers or lessees request additional Program loans.

In addition, we recommend that the Board of Directors, Guam Economic Development Authority:

4. Amend the Guam Business Development Corporation's Articles of Incorporation to create a separate Board of Directors, comprised of members other than Guam Economic Development Authority Board members, employees and their spouses, and appoint a new Board of Directors for the Guam Business Development Corporation accordingly.

## **Guam Economic Development Authority Response and Office of Inspector General Reply**

In the May 21, 2001 response (Appendix 5) to the draft report from the Authority's Chairman of the Board, the Authority expressed nonconcurrency with Recommendations 1, 2, 3, and 4. Based on the response, we consider the four recommendations unresolved (see Appendix 6).

### **Recommendation 1. Nonconcurrency.**

**Guam Economic Development Authority Response.** The Authority stated that it does not consider the Guam Business Development Corporation's (GBDC) ability to repay the loans an issue because the primary source of funds for repayment is lease income on assets of the borrower and that since the Authority is the parent corporation of GBDC, the Authority has substantial assets to fully satisfy any amounts owed by the GBDC. The Authority also stated, "[i]n the event GEDA determines that the loans to GBDC are in default, GEDA's substantial assets are able to fully satisfy any amounts owed."

**Office of Inspector General Reply.** Our review indicated that both loans (for the warehouse and the dry dock) to the GBDC, a subsidiary of the Authority, were at risk. In January 1994, the Authority approved a promissory note to postpone repayment of the loan principal for 5 years. The manufacturing company was in arrears in its rental payments to the GBDC. Without this income, the GBDC did not have available funds to repay the loan. In addition, at the time of our review, the dry dock had not generated any income because additional funding of \$5 million was needed to repair and certify the dry dock for operation. Therefore, we question the GBDC's repayment ability for either these loans or any future loans or fund advances since both loans were not generating any income for GBDC. Further, the Authority's argument that its own resources would be sufficient to pay off the GBDC loans supports our conclusion that the Authority and the GBDC did not have an arm's-length relationship with adequate checks and balances.

### **Recommendation 2. Nonconcurrency.**

**Guam Economic Development Authority Response.** The Authority said that it considers the loan of \$1.4 million for land purchase and warehouse construction and the loan of \$1.2 million for dry dock towing to the GBDC as two separate projects that individually fell below the statutory lending cap of 25 percent of the \$6.7 million Federal Government contribution to the Loan Program. The Authority also defended the rationale for the two loans, stating that the warehouse construction project and the purchase of the dry dock would create economic benefits for Guam.



**Office of Inspector General Reply.** The Authority's argument that the two loans should be viewed separately when applying the 25 percent funding limitation is not valid. Under an arm's-length relationship with a private borrower, two separate loans to the same borrower would be considered jointly with regard to the 25 percent funding limitation. Therefore, we believe that the two loans to the GBDC should also be considered jointly, even though they were for different purposes. Additionally, following the Authority's argument, it could make additional loans to the GBDC for any number of distinct purposes as long as the individual amounts did not exceed the 25 percent limitation. Under such a scenario, the loan fund could easily be depleted, given the GBDC's previous financial record. Regarding the economic justification for the two loans, the loan for warehouse construction was in default, and the facility has been vacant and unused since March 2000. The loan for relocating the dry dock was also of questionable economic benefit because the dry dock remains unused and it has been estimated that an additional \$5 million will be needed for repairs and certification of the dry dock before it will be usable.

**Recommendation 3.** Nonconcurrency.

**Guam Economic Development Authority Response.** The Authority stated that it has policies and procedures in place to administer and monitor the Development Loan Program and that the loans involved taking calculated risks. The Authority then described several loans that were successfully repaid by the borrowers and stated that these successful loans were made under the same procedures as the delinquent loans cited in the finding. However, the Authority concluded that it will review its current practices to determine if there are deficiencies.

**Office of Inspector General Reply.** While we acknowledge that the Authority had many successful loans, the finding focused on instances in which the Authority made loans to businesses that were already delinquent on prior loans. In our opinion, the Authority was not prudent in safeguarding the Loan Program's assets by repeatedly taking the unreasonable risk of giving new loans to borrowers who were already delinquent. If the Authority had effectively implemented its existing policies and procedures, it would not have approved subsequent loans until problems with the prior loans had been settled. A primary concern of the Authority should be to reasonably protect the Loan Program from abuses by delinquent borrowers.

**Recommendation 4.** Nonconcurrency.

**Guam Economic Development Authority Response.** The Authority stated that creating a separate Board of Directors for the GBDC composed of members other than Authority Board members will not address the issue of maintaining an arm's-length relationship between the two entities because the Authority will still have a controlling interest in the GBDC. However, the Authority stated that it will work to establish insider lending policies and procedures, consistent with industry standards.

**Office of Inspector General Reply.** Our review indicated that there was no separation between the Authority's Board and the GBDC's Board because the members of both boards were the same. As a result, the Board of Directors of the Authority could not perform its tasks independently from the Board of Directors of the GBDC and vice versa. Also, there were no internal controls that would prevent the Authority from unilaterally approving any of GBDC's requests because both boards were the same. We believe that if the Authority's Board was separate from the GBDC's Board, there would be a greater likelihood of independent action by the Authority and the GBDC in dealings with each other. For example, the Authority's Board might have reviewed the loan applications from the GBDC more carefully before approving the loans for the warehouse and the dry dock.

## **C. COLLECTION ENFORCEMENT**

The Guam Economic Development Authority may have lost \$2.3 million in delinquent loans and placed another \$2.2 million in delinquent loans at risk of loss<sup>8</sup> because it did not effectively approve loans and collect delinquent loans, and lost at least \$303,697 and placed another \$784,000 at risk because of the declining value of foreclosed real property. Specifically, the Authority did not (1) require that problem borrowers be referred for management assistance, (2) ensure that its attorneys took timely action to protect the Authority's interests in loan collateral, and (3) sell repossessed real property in a timely manner. These conditions occurred because the Authority had not provided training to ensure that personnel had the necessary loan collection skills, had not developed policy guidelines to ensure that the Authority's attorney took prompt action against delinquent borrowers, and had not established policies to ensure that repossessed real properties were sold timely.

### **Procedural Requirements**

The Authority's Standard Operating Procedures (Volume II, Chapter IV, Paragraph 44) state that "immediately upon receipt of notice of default, [the] Loan Division shall" ensure the borrower and the Authority are "doing everything possible to bring the loan to current status" and maintain strict followup "to avoid excessive accrual of interest." In addition, Paragraph 75 of the Procedures states, "A loan will be transferred to the 'in liquidation' classification when it is necessary to resort to the collateral or to otherwise enforce collection when the Agency's interest in the collateral . . . may be in jeopardy."

With regard to actions to be taken to assist delinquent borrowers, the Procedures state that loan delinquencies in excess of 60 days "will trigger intensive servicing activity by the loan officer since this is prime symptom of underlying problems" (Volume II, Chapter I, Paragraph 5.b(2)) and that the loan supervisor may require field visits in cases involving new loans that have the potential for problems and older problem loans (Volume II, Chapter III, Paragraph 13). Further, Paragraph 13.c of the Procedures states that "where determination has been made that a new loan has problem potential," the loan personnel should "counsel the borrower to the extent practicable with a view toward forestalling future financial difficulties," "review [the] adequacy and reliability of accounting records," and "determine whether management assistance is needed, or if borrower desires assistance." In addition, Chapter IX, Paragraph 83, states, "Specialized management assistance services will be made available to identify and resolve management deficiencies and/or prevent deficiencies from occurring in the future."

Finally, with regard to security collateral, the Procedures (Volume I, Chapter VI, Paragraph 25.A) state that "all loans shall be of such sound value or so secured as reasonable to assure repayment.

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<sup>8</sup>To avoid duplicate counting of loans discussed in Findings A and B, the amounts reported in Appendix 1 were reduced by \$359,595 for lost revenues and by \$1,236,164 for revenues at risk. Accordingly, the total amount of Funds to Be Put to Better Use for "Collection Actions" (Appendix 1) is \$2,951,018.



It is important, therefore, that the collateral securing each loan be carefully evaluated. The files should contain documentary evidence of such values."

## **Collection Actions**

Paragraph 11 of the Development Loan Program Plan requires that Loan Program procedures parallel those used by the U.S. Small Business Administration's (SBA) small business loan program.<sup>9</sup> We found that the SBA's delinquency rates for regular business loans issued in Guam and Micronesia were 13 percent of the total number of outstanding loans and 15 percent of the outstanding balances. In comparison, the Authority had delinquency rates of 66 percent of the total number of outstanding loans and 75 percent of the total amount of outstanding balances.

We judgmentally selected for review 20 loans (16 Development Loan Program loans and 4 Agriculture Program loans) out of 126 loans that were outstanding as of September 30, 1999. Of the 20 loans reviewed, 11 loans (7 Development Loan Program loans and 4 Agriculture Loan Program loans) had been delinquent for at least 1 year and averaged almost 3.5 years delinquent. Based on our analyses of the case files for each of the 11 loans, we considered the outstanding balances of unpaid principal, interest, and fees for 3 of the Development Loan Program loans totaling \$2,307,979 to be uncollectible. We also considered the outstanding balances of unpaid principal, interest, and fees for the remaining four Development Loan Program loans and the four Agriculture Loan Program loans totaling \$2,238,799 to be at risk (see Table 3).

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<sup>9</sup>When they were initially implemented, the Authority's loan procedures generally paralleled those of the SBA. However, the Authority's procedures had not been updated since 1985. Revised procedures had been drafted, but had not been adopted as of the time of our review.

**Table 3. Selected Delinquent Loans as of September 30, 1999**

					<u>Delinquent Loan Balances</u>	
<u>Loan Purpose</u>	<u>Date Loan Signed</u>	<u>Final Loan Amount</u>	<u>Principal Paid</u>	<u>Years Delinquent</u>	<u>Lost Revenues</u>	<u>Revenues at Risk</u>
<u>Development Loan Program Loans:</u>						
Manufacturing	10/05/90	\$447,631	\$91,697	4.0	\$374,738	0
Transportation*	08/07/91	1,950,000	471,767	7.0	1,573,646	0
Services **	02/14/92	150,000	0	3.7	0	\$153,492
Services ***	04/22/93	336,184	77,313	6.7	0	261,094
Manufacturing****	12/20/96	1,200,000	11,089	1.1	0	1,236,164
Services	07/13/97	87,590	3,344	1.0	0	89,742
Import****	08/31/97	<u>317,064</u>	<u>0</u>	1.5	<u>359,595</u>	<u>0</u>
Subtotals		<u>\$4,488,469</u>	<u>\$655,210</u>	3.6 Avg.	<u>\$2,307,979</u>	<u>\$1,740,492</u>
<u>Agriculture Loan Program Loans:</u>						
Farming	07/03/91	\$10,000	\$7,913	2.4	0	\$2,244
Farming	11/24/93	234,866	8,112	4.0	0	266,158
Farming	12/29/93	97,140	0	4.0	0	111,602
Farming	02/07/94	<u>166,379</u>	<u>49,265</u>	2.8	<u>0</u>	<u>118,302</u>
Subtotals		<u>\$508,385</u>	<u>\$65,290</u>	3.3 Avg.	<u>0</u>	<u>\$498,306</u>
Totals		<u>\$4,996,854</u>	<u>\$720,500</u>	3.5 Avg.	<u>\$2,307,979</u>	<u>\$2,238,798</u>

\*This was a Program-guaranteed loan that the Authority purchased from the issuing bank when the borrower declared bankruptcy in February 1993. All available assets have been liquidated and funds applied to pay outstanding interest and part of the outstanding principal. The number of years delinquent was computed from the date of the original guaranteed bank loan in 1991.

\*\*The "Years Delinquent" for this loan was calculated from the expiration date of an agreement that allowed the borrower to make interest-only payments for a specific period of time.

\*\*\*For this loan, all available assets have been liquidated, and funds have been applied to pay outstanding interest and principal.

\*\*\*\*Because these two loans were also included in Table 1 of Finding B, to avoid duplicate counting the delinquent loan balances are not included in Appendix 1 as Funds to Be Put to Better Use.

Based on our review of the Authority's efforts to collect these delinquent loans, we determined that improvements need to be made in the areas of financial analysis/management assistance and legal actions.

**Financial Analysis/Management Assistance.** Although the Authority performed on-site visits at businesses with delinquent loans, Authority staff did not perform thorough financial analyses of the businesses' ability to generate cash flows adequate to bring their delinquent loans current and continue loan payments. Authority staff also did not refer any of the delinquent businesses for management assistance. None of the loan files for the 11 delinquent loans reviewed included a detailed financial analysis of the ability of the business to repay the delinquent loan. According to both the Authority's Administrator and the Program and Compliance Officer, Authority staff needed specialized training in financial analyses to perform such reviews and to make management assistance recommendations. Further, the Authority's loan officials said that as of March 31, 2000, they had not made any referrals for management assistance for at least 5 years. The loan officials

stated that Guam did not have adequate business advisory resources to which "problem" borrowers could be referred. In our opinion, thorough financial analyses and appropriate recommendations to management would help business owners focus on key areas of the struggling businesses to improve their chances of recovery or, where necessary, ensure that the Authority took faster action to collect on collateral before it became unavailable or lost its value. For example:

- On October 5, 1990, the Authority issued to a manufacturing company a Development Loan Program loan of \$450,000, of which the company drew down \$447,631. The borrower soon had problems making loan payments, and the loan was restructured on April 1, 1993 to reduce the interest rate and extend the loan term for an additional 2 years and 3 months by reissuing the loan effective January 1, 1993 and keeping the existing 7 year payment term. However, by September 30, 1999, only 3 months before the loan term was to expire, the borrower owed \$374,738, including interest and fees, and was 4.1 years behind in loan payments. When the borrower filed for bankruptcy on November 12, 1999, only \$91,697 had been paid on the loan's principal. The Authority had acknowledged that the borrower had serious problems by placing the loan in "nonaccrual" status on December 5, 1997 and referring the loan to its attorney for collection action on January 22, 1998. However, the Authority had no record of having performed a detailed financial analysis of the company or of referring the company for management assistance. Either action might have helped the company in its financial difficulties or at least would have alerted the Authority to take timely action to recover whatever funds it could through foreclosure on the loan collateral rather than let the situation continue for 4 years. Because the company filed for bankruptcy in November 1999, as of March 31, 2000, the Authority was not in a position to initiate foreclosure proceedings against the company.

- On November 24, 1993, the Authority issued to a farming business a 3-year Agriculture Development Loan of \$402,565, of which the company drew down \$234,866. Although the Authority restructured the loan in January 1996 and again in October 1997, the borrower made only five payments on the principal and, as of September 30, 1999, owed a total of \$266,158, including interest and fees. The Authority had initiated legal action against the borrower on March 14, 1997, but the loan files contained no evidence of a financial analysis of the borrower or referral for management assistance. The business appears to have had financial difficulties from the beginning of the loan period, yet the only apparent effort made by the Authority to resolve the problem was to restructure the loan rather than to try to identify and correct the basic causes of the business's financial difficulties.

**Legal Actions.** For at least 3 of the 11 delinquent loans reviewed, the Authority did not take legal action, in a timely manner, to collect the unpaid loan. The Authority used the same legal counsel from February 1, 1995 through December 31, 1999, and according to the Authority's Administrator, the legal counsel was not aggressive in initiating collection actions.

On two occasions during 1994 the Authority took action to foreclose on the collateral of delinquent borrowers, issuing a foreclosure notice to one borrower and initiating foreclosure action against a second borrower. Shortly thereafter the borrowers agreed to begin repaying the delinquent loans, and the Authority stopped the foreclosure actions and signed forbearance agreements with the

borrowers. However, neither borrower complied with the agreements and, as of September 30, 1999, had not made any principal payments since the dates of the forbearance agreements. According to the Administrator, foreclosure proceedings were not restarted in a timely manner against the two borrowers because the legal counsel had not been aggressive in acting on the Authority's requests. In February 2000, the Authority sent one of the delinquent cases to its new legal counsel for collection action. However, as of March 2000, no further action had been taken in the second case, relating to a telecommunications company.

Regarding the telecommunications company, on February 14, 1992, the Authority issued the company a 15-year Development Loan Program loan of \$150,000, which was fully drawn down. On March 21, 1994, the Authority placed the loan in "nonaccrual" status, but the Authority did not refer the loan to its legal counsel for collection action until September 19, 1997. According to the Authority Administrator, as of March 7, 2000, the Authority's legal counsel had not taken action on the referral. In fact, the Authority's new legal counsel had to ask the Authority to provide the current status on this and other delinquent cases that had previously been referred for legal action. During a meeting on April 5, 2000, the Administrator told us that legal action was in process and that the prospects were good for collecting the \$153,492 that was delinquent as of that date.

## **Real Property Obtained by Foreclosure**

The Authority did not have written policies or procedures specifying when to dispose of real property obtained through foreclosure on defaulted loans. According to the Authority's Administrator and Chief Financial Officer, the objective of foreclosing on real property was to recover as much of the unpaid loan as possible.

However, the Authority did not act aggressively to dispose of real property acquired through foreclosures because management had not requested or obtained formal direction from the Board on how to handle the sale of Authority assets in a weak real estate market with decreasing property values. The Administrator stated that the Authority attempted to sell the properties in 1996 but that the offers received were very low. He further said that the Authority decided to delay the sale of foreclosed property until real estate values increased. However, according to the President of the Guam Board of Realtors, the Guam real estate market began to deteriorate in 1996, with appraised values of property decreasing 10 to 20 percent each year at least through 1999, with no prospect of a change in this condition in the near future. Therefore, by holding the foreclosed properties, the Authority (1) had incurred losses that we estimated to be at least \$303,697 on properties which either were sold or reduced in value between the first appraisal after acquisition and the most recent appraisal, (2) had not collected about \$784,000 on unsold properties that would then be available for lending, and (3) lost potential interest that would have been earned if these funds had been loaned.

As of October 1, 1996, the Authority owned 11 parcels of real property that it had obtained through foreclosure action on defaulted loans originally totaling \$1,444,286. The Authority valued the properties at \$901,020, which included the total amount of unpaid loan principal, interest, and fees at the time of acquisition, as shown in Table 4.

**Table 4. Real Property Acquired Through Foreclosure**

<u>Size of Parcel In Sq. Meters</u>	<u>Date Acquired</u>	<u>Years Held</u>	<u>Initial Loan Amount</u>	<u>Value at Acquisition</u>	<u>First Appraisal</u>	<u>Sales Price</u>	<u>Most Recent Appraisal*</u>	<u>Gain or (Loss) On Sale or Since First Appraisal</u>
<u>Properties Sold Since October 1, 1996:</u>								
<u>Development Loan Program Loans:</u>								
4,046	09/80	16.8	\$250,000	\$ 8,100	\$15,200	\$76,000	\$0	\$67,900
1,136	06/93	4.0	75,000	41,000	50,000	55,000	0	14,000
929	07/94	2.9	<u>130,000</u>	<u>26,097</u>	<u>25,000</u>	<u>21,000</u>	0	<u>(5,097)***</u>
Subtotals for Sold Properties			<u>\$455,000</u>	<u>\$75,197</u>	<u>\$90,200</u>	<u>\$152,000</u>	<u>\$0</u>	<u>\$76,803</u>
<u>Properties Still Held by the Authority:</u>								
<u>Development Loan Program Loans:</u>								
1,517	12/86	12.8	\$ 26,000	\$2,700	\$54,000	\$0	\$ 35,000	\$(19,000)
666	02/88	11.6	25,000	24,000	22,000	0	0 **	(22,000)****
1106	01/89	10.7	10,000	46,000	34,000	0	40,000	6,000
53,474	10/89	9.9	82,000	123,968	477,600	0	240,000	(237,600)****
1,077***	06/94	5.3	250,000	81,200	40,000	0	40,000	0
1,650***	06/94	5.3		74,900	65,000	0	65,000	0
763	10/94	4.9	296,286	136,386	194,000	0	174,000	(20,000)****
<u>Agriculture Loan Program Loan:</u>								
202,343	12/95	3.8	<u>\$300,000</u>	<u>\$336,669</u>	<u>\$190,000</u>	<u>\$0</u>	<u>\$190,000</u>	<u>0</u>
Subtotals for Unsold Properties			<u>\$989,286</u>	<u>\$825,823</u>	<u>\$1,076,600</u>	<u>\$0</u>	<u>\$784,000</u>	<u>\$(292,600)</u>
Totals			<u>\$1,444,286</u>	<u>\$901,020</u>				

\*As of September 30, 1999, the Authority's most recent appraisals of these properties were dated in July 1996. If the same amount is shown in both the "First Appraisal" and "Most Recent Appraisal" columns, this indicates that only one appraisal was performed.

\*\*Subsequent to the "First Appraisal," the property was designated as a historical preservation district, and the Authority was prohibited from selling the property. Therefore, the property essentially has no commercial market value.

\*\*\*Two properties were acquired through the foreclosure of one loan.

\*\*\*\*These losses totaled \$303,697.

In one example, on October 19, 1989, the Authority acquired a one-tenth interest in a 53,474-square-meter (more than 13 acres) undeveloped parcel of property on Guam through foreclosure to recover \$123,968 owed by a Development Loan Program borrower. We found no evidence in the loan files to indicate that the Authority attempted to sell this undivided interest. However, according to two appraisals, by 1996, the value of the property declined by almost 50 percent between 1989 and 1996. In addition, based on available records, the property was

subdivided in 1998, but, as of December 31, 1999, the Authority still did not have clear title. If the Authority had been able to force the sale of this undeveloped property in 1989 at the appraised value of \$4,776,000, we estimated that the Authority's one-tenth share before expenses would have been \$477,600. Based on the 1996 appraised value of \$240,000 for a one-tenth share, the Authority lost at least \$237, 600. Because the property apparently has been subdivided but the Authority's portion has not been clearly identified, the Authority should take action to resolve the matter as soon as possible and then sell its share of the property.

The remaining properties listed in Table 4 were all owned in their entirety by the Authority. Because the latest appraisals were performed in 1996, as of September 30, 1999 the current values of the properties were unknown. Based on the general decline of property values on Guam, however, we believe they were below the 1996 values.

## **Recommendations**

We recommend that the Chairman of the Board of Directors, Guam Economic Development Authority, direct the Authority's Administrator to:

1. Provide Authority loan officers with specialized training in financial analysis and refer businesses in financial difficulties for management assistance.
2. Establish and implement policy guidelines for timely action by Authority attorneys in addressing Authority requests for legal action on delinquent loans.
3. Establish and implement an Authority policy to sell repossessed real property as soon as possible after repossession unless a specific written justification is prepared and approved by the Board of Directors to delay the resale. The Authority should also take action to sell currently owned repossessed property.

## **Guam Economic Development Authority Response and Office of Inspector General Reply**

In the May 21, 2001 response (Appendix 5) to the draft report from the Authority's Chairman of the Board, the Authority expressed concurrence with Recommendation 2 and nonconcurrence with Recommendations 1 and 3. Based on the response, we consider Recommendations 1 and 3 unresolved and request additional information for Recommendation 2 (see Appendix 6).

### **Recommendation 1. Nonconcurrence.**

**Guam Economic Development Authority Response.** The Authority stated that it is staffed with professionals who have extensive lending experience but that it "recognizes the need for continued development of its staff to meet increased mandates and demands for its services." Therefore, it developed a training plan in October 1999 and tasked the Administration and

Operations Manager to assess the staff's training needs and develop a training schedule. The Authority also stated that it does not concur that it "did not take any action in development of financial management and referral services for program loan clients." The Authority further stated that "in-house business counseling is not a viable alternative, as there exists a conflict of interest and a liability to GEDA should its Loan Officers engage in counseling its borrowers on any aspect of their business operations."

**Office of Inspector General Reply.** We acknowledge that the Authority is staffed by professionals who have extensive commercial lending experience, especially in upper management. However, we believe that the Authority needs to develop the skills of the employees who work with the borrowers on a day-to-day basis. With regard to financial assistance, our review indicated that the Authority had not made any referrals during the last 5 years. We disagree that providing advice to businesses would constitute a conflict of interest because we did not envision that the advice or counseling would be provided by the loan officers but by other staff within the Authority dedicated to that task. Further, the Board adopted Volume II of the Standard Operating Procedures, which requires that the Authority provide various levels of assistance to delinquent borrowers. By doing so, the Authority would be able to help the businesses correct problems early and avoid more serious problems later. This approach is taken by the U.S. Small Business Administration, which provides management assistance services to participants of its programs. Nevertheless, we have revised the recommendation to require that the Authority provide loan officers with specialized training in financial analysis and refer businesses in financial difficulties for management assistance, leaving it to the Authority's discretion whether to refer troubled businesses to outside sources for management assistance or to develop an in-house capability to provide this service.

#### **Recommendation 2.** Concurrence.

**Guam Economic Development Authority Response.** The Authority stated that it had hired a new legal counsel, centralized its legal counsel activities with a Special Projects Coordinator tasked with the responsibility to monitor requests for legal assistance, and restructured its organization as related to the collection of accounts that are 30 to 90 days delinquent and those that are over 90 days delinquent.

**Office of Inspector General Reply.** Although we commend the Authority for the actions taken, the recommendation was for establishment and implementation of policy guidelines for timely legal action on delinquent loans. The response did not indicate whether such guidelines, specifying the time frames for legal action, had been developed.

#### **Recommendation 3.** Nonconcurrence.

**Guam Economic Development Authority Response.** The Authority stated that procedures for the disposal of foreclosed real property are documented in Volume III of the Standard Operating Procedures. The Authority also stated that it has made efforts to dispose of repossessed property in a timely manner but that "economic conditions have prevented several

attempts for reasonable recoupment of losses." The Authority also noted an error in a section of Table 4 of the finding and explained the circumstances related to specific examples of repossessed property cited in the finding.

**Office of Inspector General Reply.** Despite the procedures that exist in Volume III of the Standard Operating Procedures, we maintain that the Standard Operating Procedures do not include a policy specifically requiring the timely disposal of properties obtained through loan foreclosure. With regard to Table 4, we have corrected the section on "Properties Sold Since October 1, 1996" and revised the related sections of the finding accordingly. Based on the revised Table 4, we concluded that at least \$303,697 may not be available for future loans as a result of the Authority's delays in selling the properties. Of the 11 parcels acquired through foreclosure action on defaulted loans through October 1, 1996, the Authority lost \$5,097 on a sale of one parcel and had a total potential loss of \$298,600 for four other unsold parcels based on the decline in value between the first appraisals and the most recent appraisals.



**CLASSIFICATION OF MONETARY AMOUNTS\***

<u>Finding Area</u>	<u>Funds To Be Put To Better Use</u>
A. Loan Program Operations	
Legal Opinion Concerning Uncollectible Loans	\$1,338,413
Property Settlement Payment	1,327,503
B. Lending Practices	
Guam Business Development Corp. Loan	2,091,363
Loans to Delinquent Borrowers	2,150,776
C. Delinquent Loan Collections	
Collection Actions	2,951,018**
Real Property Obtained by Foreclosure	<u>1,087,697</u>
Totals	<u><u>\$10,946,770</u></u>

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\*Amounts represent Federal source funds unless otherwise noted.

\*\*Amount includes local funds of \$493,906.

**GUAM ECONOMIC DEVELOPMENT AUTHORITY  
OUTSTANDING LOANS BY FUNDING SOURCES  
AS OF SEPTEMBER 30, 1999**

<u>Loan Program</u>	<u>Number of Loans</u>	<u>Original Amount Loaned</u>	<u>Total Amount Owed</u>
Guam Development Fund	87*	\$13,628,904	\$11,748,237
Agriculture Development Fund	39	1,673,173	1,098,119
Microenterprise Development Fund	24	189,980	179,923
Development Authority Loan Fund	3	20,375	16,421
Local Arts Revolving Fund	<u>2</u>	<u>25,800</u>	<u>14,954</u>
Total	<u>155</u>	<u>\$15,538,232</u>	<u>\$13,057,654</u>

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\*Excludes three bank loans totaling \$1,980,700 guaranteed under the Guam Development Fund.

## **GUAM BUSINESS DEVELOPMENT CORPORATION'S LEGAL STRUCTURE AS OF DECEMBER 31, 1999**

On August 28, 1991, the Guam Economic Development Authority created the Guam Business Development Corporation from a predecessor corporation when the Authority's Board members, acting as the Corporation's Board, adopted amended articles of incorporation. The Corporation was a wholly owned subsidiary of the Authority.<sup>1</sup> Article 3, Section 3.01, of the Corporation's articles of incorporation states in part, "This Corporation is formed for the purpose of promoting the economic development of the Territory of Guam, acquiring and developing real property within the Territory of Guam and to promote the various interests of the Guam Economic Development Authority and the funds which it administers." Section 3.02 includes paragraphs defining the Corporation's powers, which include borrowing and lending money, buying and selling property, buying and selling securities, and promoting and improving land.

In a legal opinion dated March 22, 1989, the Authority's legal counsel responded to the question, "Can [the Authority] form a subsidiary and then loan it money from the [Guam Development] Fund in order for the subsidiary to then use the money on a project which will benefit Guam's economy?" The legal counsel's opinion stated, "The answer to [the] question is 'yes,' provided that the money is actually loaned to the subsidiary and the subsidiary uses the money in a way which develops Guam's economy, such as housing." The legal counsel also stated, "In conclusion, [the Authority's] enabling legislation expressly contemplates the type of loan under consideration here. The [Guam Development Fund] Act and [the Authority's Guam Development Fund] Plan would also permit a loan of this nature. The only considerations which might bar the loan are [the Authority's] necessary inquiry as to whether funds are otherwise unavailable and the potential conflict of interest in loaning funds to a corporation staffed by [Authority] officers or employees." The legal counsel provided this guidance so that the Authority could address the issues in the loan process. In a subsequent legal opinion dated October 29, 1993, the Authority's legal counsel stated that "it is my opinion that procurements made by a corporation in which [the Authority] owns stock are not subject to the [Guam Procurement Law]."

In a memorandum dated June 1, 1994, the Director of the Guam Department of Revenue and Taxation determined that the Corporation "is an exempt entity as to all taxes levied under Guam law." The official minutes of an August 4, 1993 meeting of the Authority's Board of Directors, when discussing transferring Authority surplus to the Development Program, state, "The Administrator explained that this [Guam Development] Fund is quite restrictive and the funds could be better used if put into the [Authority's] subsidiary which has a great deal more flexibility." The minutes also note that the Administrator "ask[ed] that the Board also authorize any surplus . . . be likewise transferred to the GBDC [Guam Business Development Corp]."

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<sup>1</sup> The Corporation's Board of Directors was the same as the Authority's Board, the Corporation's General Manager was the Authority's Administrator, and the individuals holding the Corporate offices changed with the appointment of different Authority Board members and administrators.

On August 18, 2000, the General Counsel of the Office of Inspector General issued a legal opinion (Appendix 4) in response to a question about the appropriateness of the Authority's lending to its subsidiary. The General Counsel stated, "The Authority can give a loan to a wholly owned subsidiary if the statutory eligibility criteria are met."

# LEGAL OPINION OF THE OFFICE OF INSPECTOR GENERAL'S GENERAL COUNSEL



## United States Department of the Interior

OFFICE OF INSPECTOR GENERAL  
Washington, D.C. 20240

AUG 18 2000

### Memorandum

To: Arnold Van Beverhoudt  
Regional Audit Manager, Insular Affairs

From: Patti Jamison (W.)  
Attorney-Adviser

Through: Robin Greenwald (W.)  
General Counsel

Subject: Request for Legal Opinion on the Guam Development Fund, Audit of "Loan Programs, Guam Economic Development Authority, Government of Guam" (Assignment No. N-IN-GUA-006-99-A-M)

You requested a legal opinion regarding the use of a revolving loan fund by the Guam Economic Development Authority ("Authority") pursuant to the Guam Development Fund Act ("Act"), 48 U.S.C. §§ 1428-1428e. Specifically, you asked:

- 1) whether the Authority can use the interest earned on the fund to recover administrative costs and uncollectible loan costs;
- 2) whether there are any other legal options available to the Authority to recover some or all of its administrative and uncollectible loan costs;
- 3) whether the Authority can give loans to a wholly owned subsidiary.

### Conclusion

The Authority can use the Fund's interest or the principle to recover the administrative costs of operating the loan program. The Authority cannot use the Fund's interest or the principle for uncollectible loan costs. The Authority can give a loan to a wholly owned subsidiary if the statutory eligibility criteria are met.

### Background

In 1968, Congress created the Guam Development Fund "[f]or the purpose of promoting economic development in the territory of Guam...." 48 U.S.C. § 1428. The statute provides:

For the purpose of promoting economic development in the territory of Guam, there is authorized to be appropriated to the Secretary of the Interior to be paid to the government of Guam for the purposes of this subchapter the sum of \$ 5,000,000.

Id., § 1428(a). Prior to receiving the funds, the government of Guam submits to the Secretary of the Interior a plan for the use of such funds which meets the requirements of the Act. Id., § 1428a (hereinafter the "Plan"). The Plan designates the Guam agency for the administration of the Development Fund, and sets forth the policies and procedures to be followed:

in furthering the economic development of Guam through a program which shall include and make provisions for loans and loan guarantees to promote the development of private enterprise and private industry in Guam through a revolving fund for such purposes. . .

Id., § 1428a. Additionally:

The plan provided for in section 1428a of this title shall set forth such fiscal control and fund accounting procedures as may be necessary to assure proper disbursement, repayment, and accounting for such funds

Id., § 1428c. The Secretary must approve the Plan before the funds are disbursed. Based upon the information submitted to this office, it appears the Secretary approved Guam's Plan.

During an audit of the loan program, two issues were identified. The Authority used more than \$ 4.2 million in interest revenues earned on the Fund in a 12 year period for administrative expenses and loan writeoffs. The Solicitor's Office issued two opinions, one in 1969 and the other in 1987, which concluded that the interest could not be used for either administrative costs or loan writeoffs. The 1969 opinion stated that neither the interest nor the principle could be used for administrative costs. Both opinions stated that the interest income must be added to the principle of the Fund.

The Authority obtained a legal opinion from a private attorney who concluded that the Authority could recover administrative costs and uncollected loan costs from the interest on the Fund. The opinion stated that as a matter of fact, the interest is added to the principle. The private attorney also concluded that the Authority could make loans to the wholly owned subsidiary if the statutory eligibility criteria were met.

## Analysis

### I. Interest

The first question is whether the interest accrued on the Revolving Fund can be used by the Authority or whether it has to revert back to the United States Treasury.<sup>1</sup> Although the law is not clear on this issue, it is our opinion that the unique characteristics of a revolving fund and the statutory scheme allow the Authority to retain the interest generated by the Fund's principle and to use it for carrying out the purposes of the Development Act.

Normally, interest that accrues on federal funds must be deposited in the Treasury as miscellaneous receipts under 31 U.S.C. § 3302(b) unless Congress expressly authorizes otherwise in the controlling statute. Matter of: Mr. John A. Carver, Trustee, Court Services and Offender Supervision Agency for the District of Columbia, Comp. Gen. B-283,834 (2000); Matter of: Department of the Interior, Fish and Wildlife Service – Interest Earned on Advance Payments of Grant Funds to Foreign Grantees, Comp. Gen. No. B-251,863 (1993); 62 Comp. Gen. 70, 72 (1982); 64 Comp. Gen. 96, 96 (1984). There must be legislative authority authorizing the retention and use of interest because interest earned on federal funds belongs to the United States. As such, only Congress is legally empowered under the Constitution to give away money of the United States. Art I, § 9, cl. 7; Matter of: Department of the Interior, 42 Comp. Gen. 289, 293.

Revolving funds, however, are unique. In a revolving fund, Congress authorizes a continuous program, and, after an initial appropriation to the fund, permits the continuing program to be financed by the income generated by the activity itself. 62 Comp. Gen. at 72. The statute usually authorizes income to be credited to the fund account and makes those funds available for immediate obligation. Id. The Comptroller General has stated that a revolving fund is authority to exempt money received from the program operation from the requirements of 31 U.S.C. § 3302(b), and, therefore, the money does not have to be deposited in the Treasury as miscellaneous receipts. Matter of: Mr. Winston Tabb, Associate Librarian, Library of Congress, Comp. Gen. No. B-271,127 (1997). In other words, program income can go back into the revolving fund. The Comptroller General opinions mean that the Authority can credit the repayment of loans and the interest earned on the loans back into the Fund for obligation. However, the Comptroller General has not specifically addressed whether interest generated on the principle of a revolving fund itself, as opposed to income received from the operation of the program, is exempt from 31 U.S.C. § 3302(b).

Some revolving fund statutes specifically allow interest to accrue on the principle and go back into the fund for carrying out the purposes of the statute. See e.g., 33 U.S.C. § 1383(d)(1)(6) (States can earn and use interest on the water pollution control revolving fund granted by the

<sup>1</sup> None of the legal opinions written by the Solicitor's Office or the Authority's private attorney addresses the legal authority to retain the interest generated by the Fund's principle.

Environmental Protection Agency). The Development Act, however, is silent on how interest on the principle should be treated. The statute states that the Authority will account for the Fund's repayment, but it does not state whether interest should be included or excluded in the repayment. See 48 U.S.C. § 1428c. The legislative history is similarly silent on the issue. Therefore, we looked at the statutory scheme to interpret Congressional intent.

Congress appropriated a lump sum to the Authority through the Department of the Interior for carrying out the loan program. 48 U.S.C. § 1428(a). After this initial infusion of money, the program is self-sustaining, and Congress does not have yearly fiscal budgetary involvement. Congress intended Guam to use this money to become more independent and, as a result, less reliant on Congressional financing. The legislative history states that:

The entire purpose of this Guam economic development program is to bring Guam into an economic climate so that we do not have at some future date to pour vast sums of money into Guam in order to correct a situation after an inequity has developed.

114 Cong. Rec. 29793 (1968).

The Authority does not draw down the funds from the Treasury. Instead, the Plan states that it is placed in a Guam federally insured bank under time certificates of deposit. Plan ¶11. Certificates of deposit accrue interest. The Development Act also requires the Authority to reserve at least 25% of a loan guarantee. 48 U.S.C. § 1428b. So, the statute requires a certain sum of money to be kept in the bank while the Plan states that any money in the bank will accrue interest. Therefore, it is reasonable to conclude that Congress intended the principle to accrue interest and intended the interest to go back into the Fund for the Authority's use.

All of the statutory provisions indicate that Congress intended the revolving fund to be self-sustaining, with minimal Congressional and Treasury control. The minimum reserve provision and the broad repayment provision further indicate that Congress knew funds would be accruing interest for the purpose of going back into the revolving fund. Thus, it is our opinion that the Authority can use the interest accrued on the revolving fund for authorized purposes under the Development Act. The next question is whether administrative costs and uncollectible loan costs are authorized purposes.

## 2. Administrative costs

The Authority has been using the interest earned on the principle to pay for administrative costs. As explained above, the interest can be paid back into the revolving fund and is available for carrying out the purposes of the Act.

The Authority is authorized to use the fund "for the purposes of this subchapter." 48 U.S.C. § 1428(a). The subchapter provides that the Plan submitted for approval shall name the agency in



charge of "the administration of the [P]lan." *Id.*, § 1423a. The statute also mandates the Plan to set forth "policies and procedures" to be followed by the agency in furthering economic development which includes loans and loan guarantees. *Id.* By mandating the inclusion of policies and procedures, Congress was aware that the agency would carry on administrative functions and would incur administrative costs. The use of the word "includes" indicates that Congress did not limit the agency's business to providing loan, loan insurance and loan guarantees. Therefore, the statute clearly contemplates that appropriations will be used for the administration of the fund, in addition to making loans, loan insurance and loan guarantees. As such, Congress has authorized the Authority to recover administrative costs from the revolving Fund's principle or interest.<sup>2</sup>

### 3. Uncollected loan costs

The Authority has been using the principle's interest to write-off loan losses. Such a use is not an authorized purpose under the Development Act.

The Development Act authorizes the Authority to use the revolving fund for administration, making loans, issuing loan insurance and loan guarantees. 48 U.S.C. § 1428a. For loan insurance and loan guarantees, losses are to be covered by charging premiums to the borrower. *Id.* ("...and that premium charges for the insurance and guarantee of loans shall be commensurate, in the judgment of the agency or agencies administering the fund, with expenses and risks covered."). The legislative history states the Act "requires the [premium] charges to be adequate to cover expenses and probable losses." H. Rep. No. 90-1930 (1968), *reprinted in* 1968 U.S.C.A.N. 4305, 4306. The Committee on Interior and Insular Affairs stated "the committee intends that the charges must be fixed with a bona fide intention that they will cover both expenses and probable losses." 114 Cong. Rec. 29792 (1968). The approved Plan also states that the borrower is to pay premium costs for loan insurance and loan guarantees. Operating Procedure ¶ 13.

The Plan calls for fifty percent of the interest earned on the time certificates of deposit to be placed in a "Bad Debt" sinking fund, to accrue until an amount equal to 10% of the deposit is accumulated. Operating Procedure ¶ 8. This provision seems to create a separate account derived from the Fund's principle for use by the Authority to recover bad loan losses. If so, this portion of the Plan appears unlawful.

As for losses from direct loans, the Plan states that guarantees are to be insured by way of term-life policy, if the loan is not otherwise protected through adequate collateral. The House Committee expressly stated "we have required as one means of security that there be insurance so

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<sup>2</sup> The statute also anticipates that administrative costs related to loan insurance and loan guarantees will be paid primarily from premiums charged to the borrower. The premiums go back into the fund for use in carrying out the purposes of the statute. Cong. Rec., Vol. 114, Part 23, page 29792 - 93, 90<sup>th</sup> Cong., 2<sup>nd</sup> Sess. (October 7, 1968); *See also* discussion under "Uncollected loan costs."

that these loans will be repaid." Page 29793 Cong. Rec., Vol. 114, Part 25, 90<sup>th</sup> Cong., 2<sup>nd</sup> Sess. (October 7, 1968). Because the Development Act expressly states that losses will be covered by premiums costs, collateral or insurance, the Authority cannot use the fund's interest to recover uncollected loan costs.

#### 4. Wholly owned subsidiary

The Authority has been giving loans to a wholly owned subsidiary. The Board members of the subsidiary are the same Board members of the Authority. This memorandum does not address whether the wholly owned subsidiary was legally established, or whether a particular loan violated the Development Act, a Guam statute, the Authority's regulations, or the subsidiary's by-laws. Instead, it addresses the broad question of whether a wholly owned subsidiary is legally eligible to receive loans.

The Authority must use the revolving funds to make or to guaranty loans "to promote the economic development of private enterprise and private industry." 48 U.S.C. § 1428a. In order to qualify for a loan, the applicant must satisfy the Authority that other financing is unavailable on reasonable terms and conditions. *Id.*, 1428b. The term of the loan cannot be more than 25 years, and the loan shall bear interest. *Id.*, § 1428a. As long as these and other relevant statutory criteria are met, the Development Act does not prohibit the Authority from giving loans to a wholly owned subsidiary.

cc: Roger LaRouche  
Acting Assistant Inspector General for Audits

## GUAM ECONOMIC DEVELOPMENT AUTHORITY RESPONSE

Governor  
Carl T.C. Gutierrez

Aturidad Inadianton



Ikunumihan Guahan

Lieutenant Governor  
Madeline Z. Borja

May 21, 2001

Mr. Arnold F. van Beverhoudt, Jr.  
Audit Manager for Insular Affairs  
United States Department of Interior  
C/O Mr. Samuel Paul  
Office Supervisor  
Office of Inspector General  
Pacific Field Office  
415 Chalan San Antonio, Suite 416  
Tamuning, Guam 96911



RE: Draft Audit Report on Loan Programs

Dear Mr. Van Beverhoudt:

Enclosed is the Authority's response regarding the above subject matter. Although management had been requested to respond solely to the recommendations made by the local inspectors, the Board and management felt that it was necessary to provide your office with GEDA's position on a number of issues raised throughout the body of the report. This is to provide the reader, which was released in its final version and will more than likely include the Guam Legislature and the local media, with a balanced perspective.

Should you have any questions, please do not hesitate to contact Mr. Ed Untalan, Administrator at (671) 647-4332.

Regards,

Mr. Chris Murphy  
Chairman

cc: Honorable Carl T.C. Gutierrez, Governor of Guam  
Mr. Samuel Paul, Office Supervisor - DOI Local Field Office  
Mr. Ed Untalan, GEDA Administrator  
Mr. Arthur Clark, Esq., GEDA General Counsel

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**RESPONSE TO THE  
DEPARTMENT OF INTERIOR  
INSPECTOR GENERAL'S  
DRAFT AUDIT REPORT  
ON LOAN PROGRAMS**

**Assignment No. N-IN-GUA-006-99(A)-M**

Response to the Department of Interior  
Inspector General's Preliminary Draft Report

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Response to the Department of Interior  
Inspector General's Preliminary Draft Report

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## EXECUTIVE SUMMARY

This document is the Guam Economic Development Authority's (GEDA) response to the Department of Interior, Inspector General's "Draft Audit Report on Loan Programs, Guam Economic Development Authority, Government of Guam (Assignment No. N-IN-GUA-006-99(A)-M)."

Since the receipt of the report, GEDA's staff conducted a thorough review of the draft audit report and submits its comments below. Of the report's 10 recommendations, GEDA only concurs with two and non-concurs with the remaining eight. This does not necessarily mean that the eight non-concurrences were in total disagreements. Some actually suggest both concur and non-concur in part.

It is important to note that the organization and mission of GEDA is multifaceted as opposed to other institutions with a primary focus in commercial lending. When GEDA makes a decision for action, it must approach each situation with a holistic point of view for the betterment of Guam's economy. From the mid-1990s to present, Guam has been and continues to be in a state of what can be categorized as an "economically distressed community." Since 1999, the unemployment rate has been around 15 percent, three times more than the U.S. rate. With the conditions of the economic hardships the island has experienced, GEDA decisions are premised upon creating, stabilizing, expanding and more importantly at hand is retaining the number of jobs inasmuch as possible.

The clientele market, which GEDA services and for the most part, are businesses that would not otherwise be approved by commercial lending institutions. With certain statutory and regulatory provisions for GEDA to consider these types of businesses only upon declinations from the private institutions, already indicates that its loan portfolio has a higher risk than of one from the private sector. This is a never-ending challenge of opportunity costs, which GEDA confronts day-after-day. Yet, GEDA as a catalyst must make every effort to stimulate the development of the economy.

With these things in mind, the following is GEDA's response to the report.

**Response to the Department of Interior  
Inspector General's Preliminary Draft Report**

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**LOAN PROGRAM REVIEW RESPONSE**

**A. LOAN PROGRAM OPERATIONS**

**Audit Recommendation 1.**

**Discontinue the practice of charging the Development Loan Program for the loss resulting from uncollectible loans**

**Response.**

**Non-concur.** In the past, GEDA had evaluated the option of obtaining loan loss insurance as currently recommended by the Office of the Inspector General, however, chose not to exercise its option to pursue it due to the following:

Our inquiries on this matter with local insurance industry experts reveal that the cost of such insurance premiums to GDFA borrowers is prohibitively expensive or otherwise unavailable. In charging each new borrower additional interest to cover the premium fee on top of the minimum rate mandated by the GDFA program would likely result in a more expensive GDFA loan program, and thus, conflicts with the purpose of the program.

In addition, there would result in an inequity between the low risk borrowers who are in essence subsidizing the higher risk defaulting borrowers with their payments of loan loss premiums. GEDA would also have to carry an inordinately high amount of insurance to approach the level of probable losses from existing non-performing loans. High premiums costs would force GEDA to pass on costs to future borrowers.

GEDA contends that under the GDFA Act, Congress authorized but did not require GEDA to obtain and charge loan loss insurance premiums to its borrowers. Reference in the law to premiums is permissive and not mandatory.

In addition, one may also conclude that the reference to insurance premiums can also ascribe to the insurance coverage required by GEDA on collateral provided as security for GDFA loans and was not intended to require GEDA to establish a unique loan loss insurance program.

However, as an alternative, GEDA has tasked its Chief Financial Officer to evaluate the creation of a loan loss reserve account to off set future losses, utilizing a portion of the interest earned on the GDFA loans.

**Audit Recommendation 2.**

**"Provide the Office of Insular Affairs, U. S. Dept. of the Interior, with documentation related to the \$1.34 million charged to the Development Loan Program for uncollectible loans and for the**

**Response to the Department of Interior  
Inspector General's Preliminary Draft Report**

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\$1.33 million from property settlements for its determination as to whether the funds should be reimbursed to the Development Loan Program."

**Response.**

**Non-concur.** GEDA is able to provide the requested documentation on the \$1.34 million in loans that were charged off and the \$1.33 million gain from a property settlement. However, GEDA does not concur that it should reimburse the fund for the deficiency balances on the loans that were written off and for the gain received under the property settlement cited in the audit report.

The accounts cited in the report were for loans made in the early stages of the Development fund program, during the period between the mid-1970's to the early 1980's. For the period the loans were originated to the time they were charged off in 1993 these loans continued to accrue interest.

It is GEDA's position that if the accounts had stopped accruing interest once the account was classified as "in default" then the unpaid balances would most likely have been recovered through GEDA's collection efforts over a nearly fifteen year time span, that included liquidation of collateral and filing suit against the loan guarantors.

Further analysis of these accounts most likely will show that once the interest balances are adjusted based on the default date and are then added to the remaining principal and subtracted from the recorded charge off amount, what remains will consist of a reduced amount of outstanding interest and legal fee charges resulting from collection efforts. The majority, if not all, of the principal loaned will have been recovered.

GEDA remedied this situation when it adopted a non-accrual policy in 1987 and further strengthened its collection procedures in the last few years by requiring 100% collateralization of its loans.

As to the issue on the gain, the report bases its finding on a memorandum issued by GEDA's then Loan Manager that the excess funds were to be transferred into the GDFA.

The situation that preceded the memorandum issued resulted when GEDA initiated redemptive efforts against a property held as collateral on the defaulted loan, which was foreclosed on June 1987 by the first lien-holder subject to the outstanding rights of redemption of the subordinate lien-holders.

On June 2, 1988, GEDA, as trustee for the Development Fund, exercised its right of redemption on the property utilizing the Development Funds of \$1.8 million subject to the superior lien-holders rights to re-redeem the property within a 60-day timeframe. In August 1988, the 2<sup>nd</sup> lien-holder exercised its right of redemption. In order for the Development fund to reaffirm its



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redemption, it posted with the Superior Court of Guam an additional \$860,000, which in effect exhausted the funds in the Development fund Program.

Prior to the redemptions, the borrower filed a petition for reorganization with the U. S. Bankruptcy Court in Salt Lake City. Subsequently, the U. S. Trustee in Salt Lake City filed and was granted a motion to have a trustee appointed to take control of the borrowers assets and ability to exercise its redemptive option.

As a result, GEDA was faced with a situation that required it to put up an additional \$1.2 million to sustain its previous redemption. It also had to plan on making payment to the Trustee in bankruptcy to relinquish its claims. However, the Development Loan Program had no funds available to initiate further redemptive action.

At its various Executive Board meetings on this matter, all of which complied with the public notice requirements, the Board of Directors of GEDA adopted a strategy for GEDA to acquire the property using its own funds. This was the only option remaining in order for GEDA to protect the interest of the Development Fund in the property. GEDA would make an offer to the Trustee to purchase its option to buy the first lien-holders interest.

In order to do this, on October 24, 1988, GEDA created a subsidiary corporation, the Ylig Development Corporation (which later evolved into the Guam Business Development Corporation "GBDC"), who entered into a Loan Agreement with the Port Authority of Guam to borrow \$4.8 million. Only an initial disbursement of \$2.9 million was drawn at an interest rate of 8.75% and set aside for the purchase of the Trustee's interest. The loan was secured by an assignment of all rents and income from GEDA's industrial park properties.

During the time that Ylig Development Corporation began its negotiations with the Trustee, another entity' Ylig Bay Resorts' a Utah Corporation was also negotiating with to purchase the Trustee's interest. The two entities eventually realized that in was in their mutual interest to form a joint venture to pursue all the interests in the property. Shortly thereafter, the Bankruptcy Court approved the joint ventures offer to purchase the Trustee's interest in the property.

On November 18, 1988, before the purchase of the Trustee's interest was consummated by the joint venture, a settlement was reached by all of the parties involved that would eliminate continued litigation in both the Superior Court of Guam and the Bankruptcy Court in Utah. As agreed under the settlement, Ylig Bay Resorts and Ylig Development Corporation would dissolve its joint venture, allowing Ylig Bay Resorts to purchase all the other interests and claims on the property for \$10 million.

As a result of the settlement, GEDA's subsidiary did not have to utilize the \$2.9 million, which was originally drawn, to fund the joint venture. From the settlement, it received \$2.2 million, which was used to payoff the interest on the \$2.9 million loan from the Port Authority and pay off the outstanding balances, interest and expenses on the Development Fund Loan. After all

**Response to the Department of Interior  
Inspector General's Preliminary Draft Report**

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disbursements were made, the remaining \$1.33 million was deposited into GEDA's operating fund under resolution of its Board of Directors.

If GEDA had not obtained the funding outside of the Development Fund Loan for use to continue its redemptive actions on the property, it would not been able to recover the outstanding debt payable to such fund. In addition, the report further fails to identify any legal basis of why a lender would not be entitled to receive any amount in excess of the original principal, interest and related expenses.

Also during that particular redemptive period, *GEDA was communicating its intentions and strategy to Mr. Walter Haught of the Department of the Interior, Office of the Inspector General* in order to assure Mr. Haught that GEDA was taking the steps necessary to protect its lien in the Ylig property. Mr. Haught at that time confirmed the appropriateness of GEDA's actions to recover on the loan and up until the time the settlement was reached by all the parties, GEDA did not receive any objection from the Office of the Inspector General over the course of action taken.

**Audit Recommendation 3.**

"Perform an analysis comparing the Development Loan Program with current federal loans programs in order to evaluate options for structuring the Loan Program to allow GEDA to recover reasonable loan insurance costs. Based on such an analysis, a revised Loan Program Plan should be submitted to the Office of Insular Affairs, U. S. Department of the Interior, for review prior to submission to the Secretary of the Interior for approval."

**Response.**

**Concur.** GEDA recognizes that since the inception of the GDFA loan Program 30 years ago, there may be a need for GEDA to re-evaluate the program to meet the island business community's current financial needs. This evaluation has been made a part of GEDA's Strategic Plan and GEDA's Financial Services Supervisor has been tasked with its development by December 2001.

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**B. LENDING PRACTICES**

**Audit Recommendation 1.**

**"Require a written analysis and official certification by the Administrator of the ability of the Guam Business Development Corporation to repay any future loans or other advances of funds made from the Loan Program prior to making any such loans or advances."**

**Response.**

**Non-concur.** The report questions the ability of GEDA's subsidiary, Guam Business Development Corporation ("GBDC") to repay loans made to it from the Development Fund Program.

The report's conclusion is based on four items. However, two of the items are discretionary: the interest rate and loan fees. Even so, the report does not identify any improprieties or abuse of discretion by GEDA with respect to these two items. The report does, however, note that GEDA made the loan to GBDC at the "lowest interest rate allowable under the Loan Program." Furthermore, the third item requesting three bank declinations as a part of GEDA's Standard Operating Procedures, appears to have been discretionary, and does not acknowledge that GEDA did receive and document the necessary declinations. The only questionable item is the subsidiary's ability to make repayment on the loans, which GEDA does not consider to be a collectibility issue. The primary source of repayment is from lease income on the assets, secondary income is derived from the sale of the collateral and the loans remain current to date.

In addition, secondary security on the GBDC loans can be derived from the parent corporation, which is GEDA itself. In the event GEDA determines that the loans to GBDC are in default, GEDA's substantial assets are able to fully satisfy any amounts owed.

A review of the audits conducted by GEDA's independent auditors (Deloitte and Touche) demonstrates that the loans made to the GBDC remain current and have never been classified as delinquent.

**Audit recommendation 2.**

**"Provide to the Office of Insular Affairs detailed information about the outstanding loans to the Guam Business Development Corporation for determination as to whether GEDA should reimburse the Development Loan Program the amount of the outstanding loans and stop making additional Program loans to the Corporation without verifiable sources of repayment and adequate security for the loan."**

**Response.**

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**Non-concur.** The recommendation asks that GEDA provide the Office of Insular Affairs documentation on the loans made to its subsidiary to determine if GEDA improperly issued these loans.

The audit report states that the loans of \$1.4 million made in January 1994 and the \$1.2 million made in May 1999 collectively exceeded the statutory lending cap under the GDFA loan program at 38.8 percent. Under the conditions of the GDFA program (48 U.S.C. A §148b) funding for *any single project* is limited to 25 percent of the Federal contribution of \$6.7 million. GEDA's position is that the loans made to GBDC are two separate projects for the purchase of land and construction of a warehouse and for the transportation and refurbishing of the AFDB-8 dry dock awarded to the Government of Guam from the U. S. General Services Agency. Based on this position the loan made for the warehouse project at \$1.4 million and the dry dock towing at \$1.2 million fell under the development program lending cap at 21 percent and 18 percent, respectively.

Legal opinions issued by both GEDA's legal counsel and that of the Office of the Inspector General's General Counsel conclude "the Development Act does not prohibit GEDA from giving loans to a wholly owned subsidiary, as long as the relevant statutory criteria are met."

In making the loan to the GBDC for the purchase of  $\frac{1}{4}$  acre lot and for costs of constructing a 10,000 square foot warehouse on that property, the Board determined, at that time, that there was sufficient repayment in the form of lease payments and that the asset itself was adequate collateral to secure the loan. More importantly, the use of the funds would develop Guam's economy, enhance private enterprise, and promote affordable housing. Direct benefits to Guam's economy by leasing the warehouse to the manufacturing company would be in the creation of 18 jobs, reduction of imports in construction materials estimated at \$41,400,000 (over a 20 year period), generating a multiplier effect of 1.25.<sup>1</sup> The enterprise would create an additional \$10,000 in corporate income tax and \$2 million in GRT (over a 20 year period). Indirect benefits to the economy would be in the form of reduce energy consumption by the products' consumers, which would in turn reduce housing costs and create more affordable housing - a primary mandate of GEDA.

In the case of the loan made to the GBDC for the relocation of the AFDB-8 the audit findings state that, "We do not believe that loans made to the Corporation met the Program's requirements for prudent lending, limits on maximum loan amounts, prohibition of conflicts of interest, and adequate loan collateral." The report overlooks that the loan was secured by a duly executed and recorded ship's mortgage and has a loan to value of 15%.

The finding also indicates that there is no method to enforce repayment on the loan from government of Guam. It should be pointed out that payment (principal and interest) would be from the shipyard operator, not government of Guam, once an agreement is executed between GEDA and the operator. Presently, the interest on the loan is being paid from the rents, which the operator pays to GEDA under the lease of the SRF.

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<sup>1</sup> Data used is on file.

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Finally, the finding indicates that lease income received can easily be diverted to the government of Guam's General Fund. However, since lease payments are and will continue to be paid to GEDA, there is no chance for lease payments to be diverted to the General Fund.

Regarding the overall concern whether issuance of the loan was prudent, the facts above show that it was. In addition, the report should take into account that the loan is further "secured" by GEDA's decision to sell its medium dry dock once the AFDB-8 is repaired. A bid in the amount of \$6 Million has already been received for this medium dry dock, which is more than the amount needed to repay the loan.

The Government of Guam and GEDA can sell the AFDB-8 if necessary, 5 years after it is operational. In addition, the dry dock can be sold if local GSA approval is obtained before the 5-year period elapses, as was opined by GEDA's legal counsel. Therefore, the loan can be paid off.

The purpose of the loan fund was to revitalize an existing industry and retain over 200 jobs. The Development Loan Fund to GBDC did just that, with the creation of a warehouse to stimulate renewed manufacturing opportunities within the housing industry and provided a means for the expansion of the ship repair facilities, all towards sustaining and retaining employment.

**Audit Recommendation 3.**

"Develop and implement policies and procedures to ensure that Authority personnel take prudent action, such as performing analysis of repayment ability and requiring that prior loans be brought current, to protect the Development Loan Program resources in instances when delinquent borrowers or lessees request additional program loans."

**Response.**

**Non-concur.** GEDA has in place policies and procedures, approved by the DOI, to administer and monitor the Development Loan Fund program.

The credit criteria for Development Fund Program loans are liberal and involve the taking of calculated risks, primarily so because the program prohibits the extension of credit if the financial assistance applied for is otherwise available on reasonable terms and conditions from a private lender. As a result, repayment ability on these types of loans may not necessarily result from operational cashflow, especially with those made to start-ups but through the collateralization on the loan.

Although the report made mention of several loans that were severely delinquent, the audit report failed to make a comparison between those loans and loans made that have resulted in successful small business enterprises, such as a loan made in 1987 for \$1.2 million to a family-run company to construct and equip a concrete pole manufacturing plant. This company remains actively

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engaged in business today, diversifying its operations into home construction, heavy equipment rental and development of an ice plant.

In 1994, GEDA also loaned Development Funds of \$69,000 to a sole proprietorship engaged in providing wedding services. This start-up small business' was able to penetrate into a highly competitive Japanese tourist wedding market. The U. S. Small Business Administration recognized this sole proprietorship as Guam's Small Business Person of the Year in 1995. The foregoing loans were paid in full.

Also in 1994, GEDA loaned \$150,000 to another start-up business for the manufacturing of dental prosthetic devices. This loan provided a means for local consumers to obtain prosthetics locally, making these items affordable. It also cut down on the waiting time for receipt of these items from off-island sources. While the loan remains outstanding, the loan remains in good standing.

What is important to consider is that the loans described above were made from the Development Fund Program under the same conditions as the delinquent loans cited in the audit report. GEDA, like all other commercial lenders, is unable to guarantee that there will not be any default among its portfolio, but has the processes and policies in place to pursue recovery. However, it will conduct a review of its current practices to determine if there are deficiencies. This review has been incorporated into GEDA's Strategic Plan and assigned to the Financial Services Manager to provide a review by fiscal year end 2001.

**Audit Recommendation 4.**

"Amend the Guam Business Development Corporation's Articles of Incorporation to create a separate Board of Directors, comprised of members other than Guam Economic Development Authority Board members, employees and their spouses."

**Response.**

**Non-concur.** Creation of a separate Board of Directors comprised of members other than GEDA Board members will not address the issue of maintaining an "arm's length" relationship with GEDA. The GEDA Board as the directors of the parent corporation will still have full control over the activities of its subsidiaries, due to GEDA having a controlling interest in such entities. However, GEDA will work to establish insider lending policy and procedure, consistent with industry standards.

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**C. COLLECTION EFFORTS**

**Audit Recommendation 1.**

"Provide Authority loan officers with training in conducting financial analyses and providing management assistance for businesses in financial difficulties. In addition, organizations that can provide management assistance should be identified, or an in-house capability should be developed."

**Response.**

**Non-concur.** The audit report recommends that GEDA provide its Loan Officers with additional training in financial analysis and providing management assistance for businesses in financial difficulties.

It is the position of GEDA that considering the many layers of scrutiny that all Development fund loan requests go through from initial staff review and analysis to Credit Committee evaluation and finally scrutiny by GEDA's Board of Directors, sufficient analysis, financial and otherwise, is provided.

It should be noted that GEDA is staffed with professionals with extensive lending experience. Its program staff has private sector experience in lending, escrow and collections. Its Chief Financial Officer is a Certified Public Accountant and GEDA's current Administrator possesses an extensive management background in commercial lending. In addition, its current and past Board Chairmen, who were a Vice President and Chief Executive Officer, respectively, of two of the major commercial banking institutions on Guam. Other current and past Directors are owner/managers of successful local businesses, a commercial developer, tourism experts, financial analysts, etc. all who possess the expertise necessary to scrutinize the requests made for financial assistance from the Development Loan Program.

However, GEDA recognizes the need for continued development of its staff to meet increased mandates and demands for its services. GEDA completed development of a training plan in October 1999 that has been included in its Strategic Plan. Tasked with the responsibility of continued enhancement of the program, GEDA Administration & Operations Manager has been compiling an assessment of the staff's training needs. Target date for implementation of the updated training schedule is the beginning of fiscal year 2002.

GEDA does not concur with the audit report stated that GEDA did not take any action in the development of financial management referral services for program loan clients. Prior to the establishment of a local small business assistance center, financially troubled borrowers of the program had no recourse but to seek the costly services of lawyers and private business consultants.

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Beginning in 1994, GEDA established a relationship with the University of Hawaii, Pacific Business Center ("PBC") to address the needs of its delinquent clients. Authority referrals to PBC were complicated by the fact that the Center's counselors were only assessable to clients during the PBC quarterly visits to Guam. Client relationships were difficult to sustain long distance and left many of GEDA's borrowers frustrated with the assistance received. Subsequently, GEDA ended its affiliation with the PBC.

In 1998, the Small Business Administration opened the Small Business Development Center ("SBDC") at the University of Guam. GEDA initiated referrals to the SBDC of its delinquent loan clients, these referrals were not successful for several reasons: (1) the operations of the SBDC was in its startup phase and had no real procedures in place (2) the SBDC initial operating budget limited their ability to hire sufficient counselors, as a consequence the demand for services exceed the supply of available counselors and resulted in a extended waiting period for the centers services (3) frequent management turnover of the center also contributed to the difficulty in providing GEDA clients expedient services (4) operating hours for the SBDC and its location at the University away from the main business centers of the island made it difficult for GEDA clients to access. Even today, the SBDC continues to face "growing pains" both operationally and financially.

Additionally, in-house business counseling is not a viable alternative, as there exists a conflict of interest and a liability to GEDA should its Loan Officers engage in counseling its borrowers on any aspect of their business operations. In particular, because there is a possibility that the business may fail even after performing the recommended course of action suggested by GEDA staff, this presents a liability to GEDA that is unreasonable and unacceptable.

**Audit Recommendation 2.**

"Establish and implement policy guidelines for timely action by Authority attorneys in addressing Authority requests for legal action on delinquent loans."

**Response.**

Concur. GEDA acknowledges that during the period from February 1995 through December 1999 that this was a problematic issue. However, GEDA initiated corrective measures as of Feb 2000 with the hiring of new legal counsel. In July 2000 it further addressed this issue by centralizing of all its legal counsel activities with GEDA's Special Projects Coordinator. This staff member is tasked with coordinating and monitoring requests for assistance on all matters sent to GEDA's legal counsel. As a result, collection enforcement on delinquent loan accounts is assured prompted and expeditious attention by legal counsel, reducing GEDA's risk of loss.

GEDA has also restructured its organization on collection procedures. The Financial Services Division handles collections that are 30-90 days late, while the Compliance and Internal Audit Division focuses on delinquent accounts that over 90 days.



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**Audit Recommendation 3.**

"Establish and implement an Authority policy to sell repossessed real property as soon as possible after repossession unless a specific written justification is prepared and approved by the Board of Directors to delay the resale. GEDA should also take action to sell currently owned repossessed property."

**Response.**

**Non-concur.** GEDA disagrees with the audit report's statement that it does not have written policies or procedures specifying for the disposal of foreclosed real property. Our procedures are documented in Volume III of its Standard Operating Procedures for its loan program. GEDA has made efforts to dispose of its repossessed property in a timely manner, however, economic conditions have prevented several attempts for reasonable recoupment of losses. In addition, because these properties are unimproved there has been no cost to GEDA to maintain them. GEDA acknowledges its fiduciary responsibility to recover the amount sufficient to fully retire the outstanding balance owed. At the same time, GEDA equally considers its other economically diverse mandates and missions, and must address each asset's potential for other related economic consideration, such as development, creation of new industries, etc. Functions, uncommon to other lending institutions.

As cited in Table 4 of the audit report, GEDA did not sustain a loss of \$303,000 and is not at risk for \$784,000 on its portfolio of foreclosed real property assets. The analysis provided in the audit report under Table 4 under the "properties sold" column is erroneous. The amounts cited as "value at acquisition" are in actuality deficiency amounts remaining to retire the original loan.

For example: on the parcel acquired on 09/80 the remaining balance on the original \$250,000 loan was \$8,100 at the time the parcel was repossessed, which at that time was appraised at \$15,200. GEDA then sold the parcel for \$76,000 and actually netted a gain of \$67,900 to the fund and not the loss of \$174,000 as shown. Based on information contained in Table 4, with the exception of the small loss sustained on property #3, GEDA did not sustained any substantial losses on the sale of these acquired assets.

The audit report states that "GEDA did not act aggressively to dispose of real property acquired through foreclosure..." GEDA strongly disagrees with this conclusion and has continually marketed the GDFA foreclosed properties for sale. Records show that GEDA advertised the properties for sale to the general public on almost a yearly basis, in December 1993, July 1994, December 1996, June 1997, April 1999, and June, 2000. GEDA was able to successfully sell three of the parcels advertised. Properties that remain unsold are because the offers made were insufficient to recover the balance remaining on the original loans. May 2001 is GEDA's latest advertised offering of these properties for sale to the general public. Results of the sale attempts are reported to the Board of Directors for approval.

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Recommendations and further action to be taken on the disposition of the assets is also decided at the Board meeting. For example, the audit report states that GEDA had the opportunity in 1989 to net a \$477,600 profit on the sale of a 1/10<sup>th</sup> interest in a 53,474 square meters undeveloped property.

GEDA was unsuccessful in its attempt to sell its interest in the property to the general public beginning in 1989. However, it had a very valid reason for holding on to its 1/10<sup>th</sup> interest in this property in that (1) the remaining undivided interest in the property was vested in a particular family clan, therefore, marketwise, the only real market for GEDA's 1/10<sup>th</sup> undivided interest would come from a member of the clan. (2) In the event that other owners of the property subdivide the parcel, GEDA's ability to negotiate for its acquisition amount (equates to uncollected balance of the original loan) would increase substantially. Any action by the family members to construct improvements on the property would be hampered as they would not be able to obtain clear title to the property without GEDA's cooperation. The property has been recently subdivided, and family members have approached GEDA, as predicted, to discuss the terms required by GEDA to secure a release of GEDA's interest.

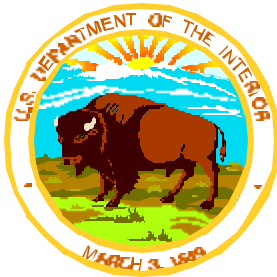
## STATUS OF AUDIT REPORT RECOMMENDATIONS

Finding/Recommendation Reference	Status	Action Required
A.1	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for stopping the practice of charging the Loan Program for losses attributable to uncollectible loans.
A.2	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for submitting documentation on the uncollectible loans and property settlements to the Office of Insular Affairs, U.S. Department of the Interior.
A.3	Management concurs; additional information requested.	Provide an action plan that includes the target date and title of the official responsible for evaluating options for restructuring the Loan Program to allow the Authority to recover loan insurance costs and for submitting a revised Loan Program Plan to the Office of Insular Affairs, U.S. Department of the Interior.

Finding/Recommendation Reference	Status	Action Required
B.1	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for submitting a written analysis and certification of the Guam Business Development Corporation's ability to repay any future loans or funds advanced from the Loan Program prior to making such loans or advances.
B.2	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for providing information on outstanding loans to the Government Business Development Corporation to the Office of Insular Affairs, U.S. Department of the Interior, and stopping the practice of approving Loan Program loans to the Corporation without verifiable repayment sources and adequate security for the loans.
B.3	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for implementing policies and procedures for analyzing the repayment ability of borrowers and requiring that payments on prior loans be current before additional loans are given to loan applicants.

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
B.4	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for amending the Articles of Incorporation of the Government Business Development Corporation to create a Board of Directors separate from that of the Guam Economic Development Authority and for appointing new Board members for the Corporation accordingly.
C.1	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for providing financial analysis training to loan officers and developing procedures for referring businesses that have financial difficulties for management assistance.
C.2	Management concurs; additional information requested.	Provide an action plan that includes the target date and title of the official responsible for developing and implementing policy guidelines that include time frames for taking legal action against delinquent loan referrals.

<u>Finding/Recommendation Reference</u>	<u>Status</u>	<u>Action Required</u>
C.3	Unresolved.	Reconsider the recommendation, and provide a response indicating concurrence or nonconcurrence. If concurrence is indicated, provide an action plan that includes the target date and title of the official responsible for developing and implementing policies and procedures for the prompt sale of property upon foreclosure on delinquent loans unless specific written justification is given by the Board to delay such sale.



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