

**GUAM HOUSING CORPORATION  
(A PUBLIC CORPORATION)**

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**FINANCIAL STATEMENTS AND  
ADDITIONAL INFORMATION AND  
INDEPENDENT AUDITOR'S REPORT**

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**YEARS ENDED SEPTEMBER 30, 2002 AND 2001**

**GUAM HOUSING CORPORATION  
(A PUBLIC CORPORATION)**

**TABLE OF CONTENTS  
September 30, 2002**

<u>Item</u>	<u>Page No.</u>
<b>I. BASIC FINANCIAL STATEMENTS</b>	
Independent Auditor's Report on Financial Statements	1
Management Discussion and Analysis	3
Statements of Net Assets	10
Statements of Revenues, Expenses and Changes in Net Assets	12
Statements of Cash Flows	13
Notes to Financial Statements	15
Supplementary Information	37
<b>II. COMPLIANCE REPORT</b>	
Independent Auditors' Report on Compliance and on Internal Control Over Financial Based on an Audit of Financial Statements	38
Schedule of Internal Control Findings:	
Summary of Audit Findings	40
Findings on Financial Statements	41

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors  
Guam Housing Corporation:

I have audited the accompanying combined financial statements of Guam Housing Corporation (GHC), a component unit of the Government of Guam, as of September 30, 2002 and 2001, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the GHC's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Guam Housing Corporation as of September 30, 2002 and 2001, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, GHC adopted the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and GASB No. 38, *Certain Financial Statements Notes Disclosures*, as of October 1, 2001. The accompanying 2001 financial statements have been restated to reflect the changes required by GASB 34.

As discussed in Note 11 to the financial statements, GHC also adopted Governmental Standards Board Statement No. 27, *Accounting for Pensions by State and Local Governmental Employees*. The accompanying 2001 financial statements have been restated to reflect the changes.

The information identified in the accompanying table of contents, as *Management's Discussion and Analysis* is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, I did not audit the information and express no opinion on it.

My audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The basic financial statements and schedules listed in the foregoing Table of Contents, which is also the responsibility of the management of GHC, is presented for purposes of additional analysis and is not a required part of the basic financial statements of GHC. These schedules are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in my audit of the basic financial statements and, in my opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, I have also issued my report dated August 29, 2003 on my consideration of Guam Housing Corporation's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.

*J. Scott Magliaro & Company*

Agana, Guam

August 29, 2003

**GUAM HOUSING CORPORATION**  
Management Discussion and Analysis  
Year Ending September 30, 2002

As management of Guam Housing Corporation, we offer the readers of the Corporation's financial statements this narrative overview and analysis of the financial activities of the Corporation for the fiscal year ended September 30, 2002.

Historical Perspective

In the early 1990's, Guam Housing Corporation expanded its primary mission of providing mortgage loans to individuals who were unable to obtain financing through conventional mortgage lenders, to include project development. As a result, the Corporation grew in size to accommodate efforts to market and develop a 400-unit housing project known as Lada Estates. For various reasons, the project was unsuccessful and the Corporation began experiencing cash flow problems associated with additional development expenses, increased personnel expenses, and increased competition in the "affordable housing" market.

Two years ago, with the Guam Housing Corporation was on the verge of a financial crisis, the Board of Directors approved a comprehensive Action and Recovery Plan to turn the corporation around and ensure its continued viability.

The Action Plan called for short-term (immediate), intermediate, and long-term actions.

**Short-Term:**

1. Obtain an immediate cash infusion of \$200,000 to sustain operations. This was accomplished through a \$200,000 advance on amounts owed by Guam Rental Corporation to Guam Housing Corporation.
2. Obtain legislative authorization to restructure Guam Housing Corporation's revolving loan fund program with the Department of Administration. This was accomplished on August 26, 2002, by Public Law 26-123.

**Intermediate Term:**

1. Reduce Guam Housing Corporation's annual personnel expense (including retirement contributions) to below \$1 million. The Corporation has since reduced the number of employees from 60 to 22, a 63% decrease in numbers, with total personnel expense for FYE 2003 estimated to be \$770,000.
2. The recruitment of an industry professional to assume management of Guam Housing Corporation. In February 2003, Governor Felix P. Camacho, appointed a President with experience in real estate and banking.

## **GUAM HOUSING CORPORATION**

### **Management Discussion and Analysis**

**Year Ending September 30, 2002**

#### Historical Perspective, continued

3. Preparations for outsourcing appropriate functions of Guam Housing Corporation's operations. The Corporation has since established a relationship with Bank of Guam to accept loan payments, and has reached an agreement with BankPacific to accept rental payments for Guam Rental Corporation.
4. The merging of Guam Rental Corporation with Guam Housing Corporation. This action was re-visited and approved by the Board of Directors in May 2003. The two corporations should be consolidated by October 30, 2003.
5. Consider the sale or lease-to-own of its 115 single-family homes (known as Lada Gardens) to first-time homeowners. The Board of Directors has not taken action on this recommendation.
6. Aggressively address the disposition of non-performing assets. As of June 2003, the Corporation has 5 Real Estate Owned properties (REO) compared to 13 as of September 2001. The Corporation has revised and expanded its policies and procedures for the disposition of REO assets bringing it in line with standard industry practice.
7. Address the disposition of the failed Lada Estates housing project. The Board of Directors have requested and received a legal opinion on the Corporation's position with respect to the disposition of this project. The Board will be formulating a disposition plan before December 2003.

#### **Long-Term:**

1. Complete personnel streamlining with respect to a recruited President's evaluation of the Corporation's programs and systems. This is on-going and will be completed once a thorough evaluation of the Corporation's systems is completed.
2. Continue debt service obligations. Pay-off Citibank note in 2003 and renegotiate or prepare for principal payments of the Federal Home Loan Bank (FHLB) note in 2003. The Citibank note was paid off on schedule in March 2003, and the remaining note was paid off in August 2003. All payments have been made as agreed on the FHLB note.
3. Continue loan originations. The Corporation placed a temporary moratorium on loan originations in order to focus all efforts on improving the quality of its loan portfolio. The Corporation began originating new loans on October 1, 2004.

**GUAM HOUSING CORPORATION**  
Management Discussion and Analysis  
Year Ending September 30, 2002

Historical Perspective, continued

Based on the implementation of the above-mentioned actions, management determined that the Corporation would be able to meet its day-to-day operations as well as all required debt service by January 2004. As of July 2003, the Corporation is now able to most all day-to-day obligations plus debt service from its operating income.

Financial Highlights

- Loan receivables totaled \$39,757,106 as of FYE September 30, 2002, being a \$3,214,454 or 7.5% decrease over FYE September 30, 2001 which totaled \$42,971,560.
- Delinquent loans totaled \$11,094,527 as of FYE September 30, 2002, being a \$1,336,712 or 13.7% increase over FYE September 30, 2001 which totaled \$9,757,815.
- The allowance for loan losses totaled \$3,299,286 or 8.2% of total loans as of FYE September 30, 2002 compared to \$3,534,730 or 8.8% of total loans for FYE September 30, 2001.
- Loan payoffs totaled \$1,816,525 as of FYE September 30, 2002 compared to \$1,047,659 for FYE September 30, 2001.
- Mortgages initiated with Revenue Bond funds totaled \$6,669,505 as of FYE September 30, 2002.
- Corporation salaries totaled \$504,810 as of FYE September 30, 2002 compared to \$1,157,457 as of FYE September 30, 2001, a \$652,647 or 56% decrease. This decrease was reflected by a 71% reduction in staff from 45 to 13 employees.

Loan Portfolio

The Corporation's loan portfolio is comprised of 783 loans, which were originated for the purpose of assisting first time homeowners who were unable to obtain financing through conventional mortgage loan programs on Guam. The loans were made to assist these individuals in the purchase and/or construction of their primary residences. All loans are secured by a first mortgage on residential single-family or condominium property.

## **GUAM HOUSING CORPORATION**

### **Management Discussion and Analysis**

**Year Ending September 30, 2002**

#### Loan Portfolio, continued

Total Loans Receivable showed little change from FYE 2001 to FYE 2002, however, it should be mentioned that the total loans receivable amount as of FYE 2002 includes \$2.9 million in loans that were not part of the Corporation's FYE 2001 balance sheet. These loans were made under four loan programs that were administered by Guam Housing Corporation on behalf of Guam Housing and Urban Renewal Authority. Included in these programs were the Community Affordable Housing Action Trust (CAHAT), Hazard Mitigation, Sagan Linayan Repair Loan Program and the Down Payment and Closing Cost Assistance Program. These programs were included in the FYE 2002 balance sheet. Taking these loans into consideration, the total loans receivable decreased \$3,214,454 or 7.5%.

These two loan programs will be redirected back to the Guam Housing and Urban Renewal Authority in FYE 2004, and will not be reflected on the FYE 2004 financial statement.

Due to the continued drop in mortgage interest rates, Guam Housing Corporation experienced approximately \$3.4 million in loan payoffs as of June 2003. This continued run-off demonstrates two key facts: 1) Guam Housing Corporation is fulfilling its mission in providing financing to individuals who are unable to borrow through conventional mortgage loan programs. Many of the individuals who are refinancing have developed a track record that has enabled them to now obtain financing through conventional mortgage programs, and 2) Due to more aggressive collection efforts, delinquent customers are finding ways to pay off their loans with Guam Housing Corporation.

We anticipate this run off to begin stabilizing during the next fiscal year as rates begin to increase. Management's continued aggressive collection activity will result in some run off as borrowers seek alternative financing.

#### Delinquency

The dollar amount of delinquent loans for FYE September 30, 2002 totals \$11,094,527 or 28% of total loans, being a \$1,336,712, or 13.7% increase over the previous period. This dollar amount and percentage includes loans under the previously mentioned Sagan Linayan Repair Loan Program and the Down Payment and Closing Cost Assistance Program which are loans administered by Guam Housing Corporation on behalf of Guam Housing and Urban Renewal Authority. Factoring these loans out reduces the dollar amount of delinquency to \$10,200,774 or 27.6% of total loans.



## **GUAM HOUSING CORPORATION**

### **Management Discussion and Analysis Year Ending September 30, 2002**

#### Loan Portfolio, continued

The increase in delinquency was attributed to the continued downturn in Guam's economy.

Guam Housing Corporation continues to work with its customers where ever possible during these difficult economic conditions. At the same time, management has made delinquency its number one priority. The Corporation has established formal policies and procedures with respect to the servicing of delinquent customers, to include placing all loans 90 days past due on non-accrual; referring all loans 90 days past due to legal counsel; and revising procedures for foreclosure and the disposition of REO assets.

Despite the continued economic downturn, management has been able to reduce the total dollar amount of delinquency to \$8.1 million as of June 30, 2003.

#### Foreclosure

The Corporation foreclosed three (3) properties during FYE 2002 compared to five (5) properties for the previous FYE 2001. Management will continue working with customers wherever possible. However, the Corporation has implemented new collection procedures which will increase the number of accounts referred to legal counsel for appropriate action.

#### Allowance for Loan Losses

The allowance for loan losses as of FYE 2002 was \$3,299,286, or 8.8% of total loans (excluding the Sagan Linayan and Down Payment and Closing Cost Assistance Program) compared to \$3,534,730, or 8.9% of total loans as of FYE 2001. The loan loss reserve exceeds the Corporation's established loan loss requirement of 3% of total loans; however, management feels that a conservative approach to the loan loss reserve is appropriate in today's economic environment.

#### Mortgage Revenue Bond

Guam Housing Corporation secured a \$50,000,000 mortgage revenue bond in conjunction with its proposed development of the 400-unit Lada Estates housing project. Due to a decline in economic activity on Guam, increased competition from private property owners, and the inability of Guam Housing Corporation to find a developer, the housing project never materialized. The Corporation was able to initiate approximately \$6.6 million in mortgage loans, before redeeming the remaining unused bond for non-origination.

**GUAM HOUSING CORPORATION**  
Management Discussion and Analysis  
Year Ending September 30, 2002

Liquidity

Due to the restructure of debt and the reduction of expenses in past years, the Corporation is now in the position to repay existing debt on its regularly scheduled due dates. The Corporation has excess cash, which can be used for lending capital or advance payments on existing debt.

Economic Factors and Next Year's Budget

Guam Housing Corporation, like most other lenders on Guam, will face continued challenges brought about by Guam's ailing economy. FYE 2003 has seen the continued increase in personal and corporate bankruptcies, high levels of unemployment, a reduction in wages and hours for government workers, and the increase in taxes and fees for government services. Real estate values continue to drop while a reduction in equity makes refinancing difficult for many homeowners. Foreclosure rates remain high, with many borrowers looking at deeds-in-lieu of foreclosure.

As management improves the quality of its portfolio, efforts to market its loan products will begin again in FY 2004, thereby offsetting continued loan payoffs and generating additional fee income.

The following factors were considered in preparing the Corporation's budget for FYE 2004:

1. Interest Rates: Over the past year, 30-year fixed mortgage interest rates continued to decrease. Interest rates are expected to level off or increase in 2004.
2. Delinquency/Collections: Despite the continued decline in economic activity, management has established comprehensive collection policies and procedures which will improve the Corporation's cash flow in FY 2004.
3. Staffing: The Corporation has reduced its staff substantially over the past two years, however, there will be a need for one additional staff member in the accounting department.
4. Typhoon Pongsona: Due to the recent super typhoon, Guam Housing Corporation will need to spend \$212,655 (less \$58,500 on items covered by FEMA) in capital improvements to repair its office and replace its Furniture, fixtures and equipment.

## **GUAM HOUSING CORPORATION**

### **Management Discussion and Analysis**

**Year Ending September 30, 2002**

#### Economic Factors and Next Year's Budget, continued

5. Debt Service: Due to the Corporation's ability to payoff its debt with Citibank ahead of schedule and the implementation of a monthly principal and interest loan payment with the Federal Home Loan Bank, the Corporation's cash flow will improve in FY 2004.
6. Business Development: The Corporation will begin making loans again under its various loan programs in FY 2004.

#### Contacting the Corporation's Management

The financial report is designed to provide a general overview of the Corporation's finances. Questions concerning any of the information provided in this report or requests for additional information may be addressed to the President, Guam Housing Corporation, PO Box 3457, Hagatna, Guam 96932, or you may call at (671) 647-4146.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Statement of Net Assets  
September 30, 2002

<u>ASSETS</u>	<u>2002</u>	<u>2001</u> As restated (note 11)
Current Assets:		
Unrestricted assets:		
Cash and cash equivalents (notes 1, 2 and 9)	\$ 1,403,215	\$ 1,400,042
Loans receivable (notes 1, 4, 10 and 12)	3,622,962	3,225,392
Accrued interest receivable (notes 4, 10 and 13)	261,198	1,235,931
Prepaid expenses and other	15,050	18,814
Total unrestricted assets	<u>5,302,425</u>	<u>5,880,179</u>
Restricted assets:		
Cash and cash equivalents (notes 1, 2 and 9)	1,740,295	684,790
Investments (notes 3, 8 and 9):	7,045,426	51,837,089
Other receivables (note 5)	3,308,797	338,750
Total restricted assets	<u>12,094,518</u>	<u>52,860,629</u>
Total current assets	<u>17,396,943</u>	<u>58,740,808</u>
Loans receivable (notes 1, 4, 10 and 12)	29,329,856	32,525,572
Due from Government of Guam and other agencies (note 13)	2,915,000	3,102,851
Land held for development (note 13)	13,199,338	13,193,988
Foreclosed assets held for resale (note 7)	1,194,812	1,201,166
Capital assets, net (note 6)	15,903	32,875
Deferred bond issue costs (note 1)	<u>-</u>	<u>787,080</u>
Total assets	<u>\$ 64,051,852</u>	<u>\$ 109,584,340</u>

See accompanying notes to financial statements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Statement of Net Assets, Continued  
September 30, 2002

<u>LIABILITIES AND NET ASSETS</u>	<u>2002</u>	<u>2001</u> <u>As restated</u> <u>(note 11)</u>
Current liabilities:		
Payable from unrestricted assets:		
Accounts payable and accrued expenses (note 14)	\$ 10,796,984	\$ 11,123,002
Current portion of accrued annual leave (note 1)	36,171	51,672
Total payable from unrestricted assets	<u>10,833,155</u>	<u>11,174,674</u>
Payable from restricted assets:		
Accrued interest payable	102,216	836,063
Deposits by borrowers - insurance premiums and real estate taxes	877,244	770,239
Rebate liability (note 8)	871,609	829,836
Current portion of notes payable (note 10)	3,769,109	1,946,090
Total payable from restricted assets	<u>5,620,178</u>	<u>4,382,228</u>
Total current liabilities	<u>16,453,333</u>	<u>15,556,902</u>
Non-current liabilities:		
Payable from unrestricted assets:		
Long-term portion of accrued annual leave (note 1)	84,399	120,569
Accrued unfunded liability to retirement fund (note 11)	175,905	208,295
Payable from restricted assets:		
Bonds payable (note 8)	5,785,749	51,058,093
Long-term portion of notes payable (note 10)	10,183,353	28,570,815
Loans held in trust (note 5)	1,292,698	-
Total non-current liabilities	<u>17,522,104</u>	<u>79,957,772</u>
Total liabilities	<u>33,975,437</u>	<u>95,514,674</u>
Net assets:		
Restricted (note 10)	21,418,930	5,123,752
Unrestricted	8,657,485	8,945,914
Total net assets	<u>30,076,415</u>	<u>14,069,666</u>
Commitments and Contingencies (note 14)	<u>\$ 64,051,852</u>	<u>\$ 109,584,340</u>

See accompanying notes to financial statements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Statements of Revenues, Expenditures and Changes in Net Assets  
Years Ended September 30, 2002 and 2001

	2002	2001 As restated (note 11)
Operating Revenues:		
Interest on loans receivable	\$ 2,239,855	\$ 3,116,201
Interest on investments held by bond trustees	573,461	2,752,075
Loan origination fees	80,382	61,743
Mortgage revenue bonds loan origination fees	-	3,800
Total operating revenues	<u>2,893,698</u>	<u>5,933,819</u>
Operating Expenses:		
Interest expense	1,549,995	3,896,035
Amortization of bond issuance costs	787,080	45,541
Salaries	476,305	1,282,788
Bad debts	275,866	2,423,925
Retirement contributions (note 11)	82,396	138,672
Contractual services	55,528	78,646
Professional services	53,250	43,940
Loan origination costs	45,132	35,644
Other	30,130	66,328
Bond trustee fees	23,958	114,958
Depreciation	21,013	49,754
Employee benefits, other than retirement	20,868	58,985
Rent	20,435	-
Directors' fees	2,300	3,000
Travel	2,100	8,535
Total operating expenses	<u>3,446,356</u>	<u>8,246,751</u>
Loss from operations	<u>(552,658)</u>	<u>(2,312,932)</u>
Non-operating Revenues (Expenses):		
Management fees	144,122	194,210
Interest income on bank deposits	55,732	72,058
Other income	64,375	86,551
Total non-operating expenses	<u>264,229</u>	<u>352,819</u>
Loss before extraordinary and special items	<u>(288,429)</u>	<u>(1,960,113)</u>
Special items (notes 5 and 10)	<u>16,295,178</u>	<u>-</u>
Increase (decrease) in net assets	16,006,749	(1,960,113)
Total net assets at beginning of year	<u>14,069,666</u>	<u>16,029,779</u>
Total net assets at end of year	<u><u>\$ 30,076,415</u></u>	<u><u>\$ 14,069,666</u></u>

See accompanying notes to financial statements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Statements of Cash Flows  
Years Ended September 30, 2002 and 2001

	2002	2001 As restated (note 11)
Cash flows from operating activities:		
Receipts received from customers	\$ 3,479,425	\$ 4,909,966
Payments to suppliers	(336,097)	(614,291)
Payments to employees	(476,305)	(1,263,936)
Other operating receipts	<u>653,843</u>	<u>65,543</u>
Net cash provided by operating activities	<u>3,320,866</u>	<u>3,097,282</u>
Cash flows from investing activities:		
(Increase) decrease in investments	44,791,663	(67,314)
Interest earned on cash and investments with trustees	573,461	2,452,972
Increase in land held for development and resale	(5,350)	(21,131)
Management fees	144,122	194,210
Interest income on bank deposits	55,732	72,058
Other income	64,375	86,551
Proceeds from sale of property and equipment	92,928	747,827
Purchase of property and equipment	<u>(4,184)</u>	<u>(9,545)</u>
Net cash provided by investing activities	<u>45,712,747</u>	<u>3,455,628</u>
Cash flows from capital and financing related activities:		
Repayment of bonds payable	(44,220,000)	-
Repayment of notes payable	(3,128,619)	(1,944,630)
Premium on bonds payable	1,052,344	35,868
Interest paid on notes payable	(970,285)	(1,247,592)
Interest paid on bonds	<u>(708,375)</u>	<u>(2,648,442)</u>
Net cash used for financing activities	<u>(47,974,935)</u>	<u>(5,804,796)</u>
Net increase in cash and cash equivalents	1,058,678	748,114
Cash and cash equivalents at beginning of year	<u>2,084,832</u>	<u>1,336,718</u>
Cash and cash equivalents at end of year	<u>\$ 3,143,510</u>	<u>\$ 2,084,832</u>
Cash and cash equivalents	\$ 1,403,215	\$ 1,400,042
Restricted cash and cash equivalents	<u>1,740,295</u>	<u>684,790</u>
Total cash and cash equivalents, end of year	<u>\$ 3,143,510</u>	<u>\$ 2,084,832</u>

See accompanying notes to financial statements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Statements of Cash Flows, Continued  
Years Ended September 30, 2002 and 2001

	2002	2001 As restated (note 11)
Reconciliation of Operating Loss to Net Cash		
Provided (Used) By Operating Activities:		
Operating loss	\$ (552,658)	\$ (2,312,932)
Adjustments to reconcile net earnings to net cash (used in) provided by operating activities:		
Depreciation	21,013	49,754
Amortization of bond issuance cost	787,080	45,541
Amortization of discount on loan due from Guam Rental Corporation	(30,000)	(30,000)
Provision for loan losses	235,444	2,423,935
(Gain) loss on disposal of fixed assets	143	(5,158)
(Increase) decrease in assets:		
Loans receivable	2,798,146	2,599,543
Accrued interest receivable	974,733	294,426
Due from Government of Guam	187,851	-
Other receivables	(109,502)	(154,622)
Prepaid expenses and other	3,764	3,599
Increase (decrease) in liabilities:		
Accounts payable and accrued expenses	(326,018)	(125,013)
Rebate liability	41,773	235,925
Accrued pension cost	(32,390)	87,446
Deposits by borrowers	107,005	(91,709)
Accrued interest payable	(733,847)	107,213
Accrued annual leave	(51,671)	(30,666)
Net cash provided by operating activities	<u>\$ 3,320,866</u>	<u>\$ 3,097,282</u>
Supplemental disclosure of cash flow information:		
Cash payments during the year for interest	<u>\$ 1,046,576</u>	<u>\$ 1,247,593</u>
Loans foreclosed and transferred to assets held for resale during the year	<u>\$ 408,208</u>	<u>\$ 406,285</u>

Non-cash transactions:

In August 2002, the Guam Housing Corporation recorded a reduction in notes payable - Government of Guam of \$13,650,013 plus accrued interest payable of \$517,402 due to the forgiveness of debt pursuant to Public law 26-123 passed by the 26th Guam Legislature. Accordingly, the amounts were transferred to restricted net assets to establish a permanent revolving loan fund to finance home mortgages.

In 2002, the Corporation elected to record an additional receivable and liability for loans held in-trust for various programs under its management which totaled \$2,860,545 and \$1,292,698, respectively.

See accompanying notes to financial statements.



**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(1) Organization and Summary of Significant Accounting Policies

Organization

Guam Housing Corporation (the Corporation), a component unit of the Government of Guam, was created by Public Law 8-80 to promote the general welfare of the Territory of Guam by encouraging investment in and development of low cost housing. As such, the Corporation is not subject to taxes. The Corporation is principally engaged in financing homes for low and moderate-income families.

Fund Structure, Measurement Focus, and Basis of Accounting

The accounts of the Corporation are organized as a proprietary fund-component unit of the Government of Guam. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to private business enterprises. The purpose of proprietary funds is to provide periodic determination of revenues, expenses and net income, with maintenance of capital.

Proprietary funds are accounted for on a flow of economic resources measurement focus, whereby all assets and liabilities associated with the operations of the funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Operating statements present increases and decreases (i.e., revenues and expenses, respectively) in total net assets. This is in contrast with "governmental" fund type accounting, which are accounted for using a current financial resources measurement focus whereby only current assets and current liabilities are generally included on the balance sheet.

The financial statements of the Corporation have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to governmental entities. Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary and Other Governmental Entities that Use Proprietary Fund Accounting," requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Guam Housing Corporation has implemented GASB 20 and elected to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(1) Organization and Summary of Significant Accounting Policies, continued*

Fund Structure, Measurement Focus, and Basis of Accounting, continued

During 2002, GHC implemented GASB Statement No. 33, "Accounting and financial Reporting for Nonexchange Transactions", GASB Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Government", GASB Statement No. 36, "Recipient Reporting for Certain Shared Nonexchange Revenues", GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus", GASB Statement No. 38, "Certain Financial Statement Note Disclosures", and GASB Interpretation No. 6 "Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements."

GASB Statement Nos. 33 and 36 establish accounting and financial reporting standards for nonexchange transactions involving financial or capital resources. The timing for the recognition of assets, liabilities, and expenditures/expenses resulting from nonexchange transactions will be the same whether the accrual or modified accrual basis of accounting is required. For revenue recognition to occur on the modified accrual basis, however, the criteria established for accrual basis revenue recognition must be met and the revenue must be available.

GASB Statement No. 34 creates new basic financial statements for reporting on the Corporation's financial activities. The financial statements now include government-wide financial statements prepared on an accrual basis of accounting and fund accounting financial statements which present information for individual major funds rather than by fund type. Requirements in order to comply also include adopting depreciation on capital assets and classifying assets and liabilities as current and non-current.

GASB Statement No. 37 clarifies certain provisions of GASB Statement No. 34, including the required content of the Management Discussion and Analysis, the classification of program revenues and the criteria for determining major funds. GASB Statement No. 38 modifies, establishes and rescinds certain financial statement note disclosures. GASB Interpretation No. 6 clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice.

The accounts of GHC are organized and operated on the basis of funds and grant programs. A fund is an independent fiscal year and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(1) Organization and Summary of Significant Accounting Policies, continued*

Cash and Cash Equivalents

For purposes of the balance sheets and the statements of cash flows, certificates of deposit with original maturities of three months or less are considered to be cash and cash equivalents (see also note 2).

Property and Equipment

The Corporation generally capitalizes all expenditures for property and equipment in excess of \$500 in 2002 and 2001, respectively.

Depreciation of property and equipment is computed using the straight-line method over estimated useful lives of 2 to 10 years for vehicles and office furniture and equipment, and over the length of the lease term for leasehold improvements.

Lending Policies

The Corporation is permitted to make loans for the purchase, construction, or purchase of land and construction of homes not to exceed the loan limit established by the U.S. Department of Housing and Urban Development. Loan limits currently range from \$180,500 for single-unit dwellings to \$285,000 for four-unit dwellings. However, the Corporation accepts loan applications only for single-unit dwellings. Determination of loan interest rates is made by the Board of Directors of the Corporation but does not exceed the Federal Housing Administration rate. In August 2002, Public Law 26-123 was passed to reduce the Corporation's loan limits to range from \$57,400 for two bedroom dwellings to \$91,000 for four bedroom dwellings. Loans for five bedroom dwellings and over are subject to Board review and approval provided that dwelling area construction cost does not exceed \$70 per square foot.

Loans and Allowance for Loan Losses

Loans are stated at unpaid principal balances, less the allowance for loan losses and net deferred loan fees. The allowance for loan losses is maintained at a level, which in management's judgment is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance is based on management's evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, credit concentration, trends in historical loss experience, specific impaired loans, economic conditions, and other risks inherent in the portfolio. The allowance is increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, net of recoveries. Because of the uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the loan portfolio and the related allowance may change in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(1) Organization and Summary of Significant Accounting Policies, continued*

Deferred Bond Issue Cost

Bond issue costs are treated as a deferred asset and are amortized on a weighted-average basis over the lives of the bonds outstanding.

Premium on Bonds

The premium on the Single Family Mortgage Revenue Bonds 1998 Series A is being amortized on a straight-line basis over the life of the bond issue.

Accrued Vacation Leave

Employees are credited 104, 160 or 208 hours of vacation leave per fiscal year, subject to their lengths of service. The accumulation of vacation credits is limited to 480 at fiscal year-end and is convertible to pay upon termination of employment. The Corporation recognizes as a liability all vested vacation leave benefits accrued by its employees. Sick leave does not vest and is not accrued. When vacation leave benefits are used by the employees, the liability account is reduced accordingly. As of September 30, 2002 and 2001, accrued annual leave totaled \$120,570 and \$172,241, respectively. The aggregate amount of the sick leave liability has not been estimated.

Loan Origination Fees and Related Costs

Loan fees and certain direct loan origination costs are deferred, and the net fee or cost is recognized in income or expense using the straight-line method over the contractual life of the loans. Differences between this method and the interest method required by Financial Accounting Standard No. 91 are not significant and do not otherwise materially affect the accompanying financial statements.

Risk of Loss

The Corporation is self-insured as to property and equipment. Losses are recorded in the fiscal year realized.

Recognition of Revenues and Expenses

Revenues and expenses are recognized on the accrual basis of accounting.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(1) Organization and Summary of Significant Accounting Policies, continued*

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans and the valuation of foreclosed real estate properties. In connection with the determination of the estimated losses on loans and foreclosed properties, management obtains independent appraisals for significant properties.

A majority of the Corporation's loan portfolio consists of single-family residential loans in the Territory of Guam. The regional economy depends heavily on tourism, which is currently in economic decline. Real estate prices in this market are also depressed. Accordingly, the ultimate collectibility of a substantial portion of the Corporation's loan portfolio and the recovery of the carrying amount of foreclosed real estate are susceptible to changes in local market conditions.

While management uses available information to recognize losses on loans and foreclosed real estate, further reductions in the carrying amounts of loans and foreclosed assets may be necessary based on changes in local economic conditions. Because of these factors, it is reasonably possible that the estimated losses on loans and foreclosed real estate may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

Reporting Fund Net Assets

With the implementation of GASB 34, the reporting of contributed capital and retained earnings have completely changed. As stated in paragraph 98, governments are now required to report proprietary fund net assets or fund equity in three components which are as follows: Invested in capital assets, net of related debt, Restricted and Unrestricted. "Retained earnings", "contributed capital" and "designations" should no longer be used on the face of the proprietary fund financial statements, even as a subcomponent of one of the required net assets components. Also, capital contributions are no longer reported as direct additions to fund equity but are reported in the all-inclusive statement of revenues, and changes in net assets. In the current year, the Guam Housing Corporation classified and included contributions to Retained Earnings in the Statement of Revenues, Expenses and Changes in Fund Net Assets. For comparative purposes, amounts reported in the 2001 financial statements have been reclassified to conform to current year presentation as required by GASB 34.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(1) Organization and Summary of Significant Accounting Policies, continued*

Reclassifications

Certain reclassifications have been made to the 2001 financial statements to conform with the 2002 presentation.

*(2) Cash and Cash Equivalents*

Cash and cash equivalents insured by the Federal Deposit Insurance Corporation (FDIC) are \$1,024,107 and \$980,354 as of September 30, 2002 and 2001, respectively, with the remaining uninsured balances being uncollateralized, as follows:

	<u>2002</u>	<u>2001</u>
Commercial, trust and savings accounts	\$ 2,118,603	\$ 1,102,878
On-hand	<u>800</u>	<u>1,600</u>
	<u>\$ 2,119,403</u>	<u>\$ 1,104,478</u>

*(3) Restricted Investments*

Restricted investments consist of the following:

	<u>2002</u>	<u>2001</u>
Foreclosure protection fund	\$ 375,921	\$ -
Investments held by bond trustees	<u>6,669,505</u>	<u>51,837,089</u>
	<u>\$ 7,045,426</u>	<u>\$51,837,089</u>

The foreclosure protection fund is used by the Corporation to protect the interest of Guam's Community Affordable Housing Action Trust (CAHAT) program as the second mortgage and is used exclusively for the purpose of paying off the first mortgage on foreclosure. Investments held and administered by the Corporation's bond trustees relate to the mortgage revenue bonds (see notes 8 and 9).

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(4) Loans Receivable

Loans receivable, collateralized by first mortgages on real estate, consist of the following:

	<u>2002</u>	<u>2001</u>
Due in varying monthly installments and interest rates with maturities to 2024, including loans in process of \$89,147 in 2002 and \$364,139 in 2001.	\$ 36,323,346	\$ 39,165,309
Due in varying monthly installments and interest rates with maturities to 2003, purchased from Citibank, N.A. which acts as a servicing agent, insured by the Federal Housing Administration (FHA).	41,415	165,910
Due from Guam Rental Corporation in monthly installments of \$6,675 including interest of 3% per annum, net of unamortized discount of \$108,710 in 2002 and \$138,710 in 2001.	225,018	263,976
Due from other government agencies	- 36,589,779	49,271 39,644,466
Less net deferred loan origination fees	(337,675)	(358,772)
Less allowance for loan loss	(3,299,286)	(3,534,730)
	32,952,818	35,750,964
Less current portion	<u>3,622,962</u>	<u>3,225,392</u>
	\$ <u>29,329,856</u>	\$ <u>32,525,572</u>

A significant portion of the total loans outstanding is assigned as collateral on notes payable (see note 10). Included in outstanding loans are loans to employees of \$967,351 and \$1,457,546 at September 30, 2002 and 2001, respectively. These loans meet the same criteria as all real estate loans made to non-related individuals by the Corporation. Loans in arrears three months or more or held with the attorney for collection totaled \$6,255,612 and \$4,540,609 at September 30, 2002 and 2001, respectively.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(5) Other Long-Term Receivables

In 2002, the Corporation elected to record a receivable and the corresponding liability for loans under the Community Affordable Housing Action Trust (CAHAT), Hazard Mitigation, Down Payment and Closing Assistance, and the Sagan Linayan Project programs. These programs are interest-free loans solely to assist first-time homeowners for purposes of retrofitting for typhoon proof homes. The Foreclosure Protection Fund is restricted for the purpose of protecting the interest of CAHAT loans.

As of September 30, 2002, the receivable due from borrowers for loans was \$2,860,545 and consisted of the following:

CAHAT	\$ 1,635,709
Down-payment Assistance Program	825,654
Hazard Mitigation Program	90,792
Sagan Linayan Project	<u>308,390</u>
	2,860,545
Other receivables	<u>448,252</u>
	<u>\$ 3,308,797</u>

Correspondingly, the liability recorded by the Corporation for the loans held in-trust at September 30, 2002 totaled \$1,292,698 and consisted of the following:

Down-payment Assistance Program	\$ 870,896
Hazard Mitigation Program	108,200
Sagan Linayan Program	<u>313,601</u>
	<u>\$ 1,292,698</u>

The Down Payment and Closing Assistance and the Sagan Linayan Project programs were funded by the Guam Housing and Urban Renewal Authority with monies received from the U. S. Department of Housing and Urban Development. The Hazard Mitigation Program was funded with monies received from the Federal Emergency Management Agency in 1995. The CAHAT and Foreclosure Protection Fund programs were funded by appropriations received from the Government of Guam in Public Law 21-99. The Corporation recorded a special item as other revenue in 2002 totaling \$2,127,763 resulting from the recording of appropriations received for the CAHAT and Foreclosure Protection fund.



**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(6) Capital Assets

Capital assets consist of property and equipment as summarized below:

	Balance 9/30/2001	Additions	Disposals	Balance 9/30/2002
Office Furniture and equipment	\$ 407,397	\$ 4,184	\$ (49,313)	\$ 362,268
Vehicles	101,826	-	(42,196)	59,630
Leasehold improvements	209,502	-	-	209,502
	718,725	4,184	(91,509)	631,400
Less: Accumulated depreciation	(685,850)	(21,013)	91,366	(615,497)
Capital Assets, net	<u>\$ 32,875</u>	<u>\$ (16,829)</u>	<u>\$ (143)</u>	<u>\$ 15,903</u>

(7) Foreclosed Asset Held for Resale

Foreclosed asset held for resale represents eight buildings acquired by GHC due to the borrowers' default on their mortgages. The buildings are not subject to depreciation because they represent foreclosed properties held for resale.

(8) Long-Term Mortgage Revenue Bonds Payable

On April 15, 1998, the Corporation issued \$50,000,000 (Guaranteed Mortgage-Backed Securities Program) 1998 Series A tax-exempt Single Family Mortgage Revenue Bonds. The bonds were issued for the purpose of providing monies to engage in a home-financing program within the territory of Guam. Interest on the bonds is payable semi-annually on March 1 and September 1 of each year, commencing on September 1, 1998 at various rates noted below.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(8) Long-Term Mortgage Revenue Bonds Payable, continued

Revenue bonds payable as of September 30, 2002 and 2001, consist of the following:

	<u>2002</u>	<u>2001</u>
Single Family Mortgage Revenue Bonds 1998 Series A, with varying interest rates (4.45% - 5.25%) payable semiannually on March 1 and September 1, principal payments due in varying semiannually installments with \$45,000 due in March 2002, and increasing to \$75,000 by September 2013.	\$ 1,215,000	\$10,965,000
Single Family Mortgage Revenue Bonds 1998 Series A, with interest rate of 5.35% payable semiannually on March 1 and September 1, principal and mandatory sinking fund payments due in varying semiannually installments with \$74,931 due in March 2014, and increasing to \$95,420 by September 2018.	850,000	7,260,000
Single Family Mortgage Revenue Bonds 1998 Series A, with interest rate of 4.70% payable semiannually on March 1 and September 1, principal and mandatory sinking fund payments due in varying semiannually installments with \$108,434 due in March 2019, and increasing to \$119,511 by September 2021.	685,000	5,875,000
Single Family Mortgage Revenue Bonds 1998 Series A, with interest rate of 5.75% payable semiannually on March 1 and September 1, principal and mandatory sinking fund payments due in varying semiannually installments with \$114,064 due in March 2022, and increasing to \$194,200 by September 2031.	<u>3,030,000</u>	<u>25,900,000</u>
	5,780,000	50,000,000
Add net unamortized premium on bonds	<u>5,749</u>	<u>1,058,093</u>
	<u>\$ 5,785,749</u>	<u>\$51,058,093</u>

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(8) Long-Term Mortgage Revenue Bonds Payable, continued*

The accrued interest expense on the above bonds totaled \$25,922 and \$223,692 at September 30, 2002 and 2001, respectively. Total interest expense on the bonds totaled \$503,419 and \$2,648,443, net of amortized bond premium at September 30, 2002 and 2001. Accrued interest income earned on bonds totaled approximately \$29,602 and \$241,256 as of September 30, 2002 and 2001, respectively.

The Corporation is required to calculate rebatable arbitrage as of the last day of any Bond year pursuant to the provisions of the U.S. Department Treasury Regulation Section 1.148. The arbitrage provisions require the Corporation to rebate excess arbitrage earnings from bond proceeds to the federal government. As provided for by the bond indenture, this amount has been recorded as "Rebate Liability" for the benefit of the federal government and will be paid as required by applicable regulations. As of September 30, 2002 and 2001, the rebate liability totaled \$871,609 and \$829,836, respectively.

The bonds are limited obligations of the Corporation payable from the revenues and other assets pledged for the payment thereof and are not a lien or charge upon the funds of the Corporation, except to the extent of the pledge and assignment set forth in the Indenture and in the bonds. The bonds do not constitute indebtedness or a loan of credit of the Government of Guam or the United States of America, within the meaning of the Organic Act of Guam or statutory provisions. Neither the faith and credit nor the taxing power of the Government of Guam is pledged to the payment of the principal of, or interest on the bonds. The Corporation has no taxing authority. The bonds are not a debt, liability or obligation of the Government of Guam, and said Government of Guam is not liable for the payment thereof.

The bonds maturing on September 1, 2031 are not subject to optional redemption prior to maturity. The bonds maturing after September 1, 2008 but on or before September 1, 2021 are subject to redemption on any date on or after September 1, 2008, at the option of the Corporation, in whole, or in part from such maturities as are determined by the Corporation, from any source of available monies, at the redemption prices (expressed as percentages of the principal amount) set forth below, plus accrued interest thereon to the date fixed for redemption:

<u>Redemption Dates</u>	<u>Redemption Prices</u>
September 1, 2008 through August 31, 2009	101.0%
September 1, 2009 through August 31, 2010	100.5%
September 1, 2010 and thereafter	100.0%

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(8) Long-Term Mortgage Revenue Bonds Payable, continued

The bonds maturing on September 1, 2018 are subject to mandatory redemption prior to maturity at a redemption price equal to 100% of the principal amount redeemed, plus accrued interest thereon to the date fixed for redemption, from sinking fund installments which are required to be made in amounts sufficient to redeem on the dates specified below the respective principal amount of such bonds specified as follows:

As of September 30, 2002:

<u>Date</u>	<u>Principal Amount</u>	<u>Date</u>	<u>Principal Amount</u>
March 1, 2014	\$ 74,931	September 1, 2016	\$ 85,468
September 1, 2014	\$ 77,273	March 1, 2017	\$ 88,395
March 1, 2015	\$ 79,614	September 1, 2017	\$ 90,737
September 1, 2015	\$ 81,371	March 1, 2018	\$ 93,079
March 1, 2016	\$ 83,712	September 1, 2018	\$ 95,420

As of September 30, 2001:

<u>Date</u>	<u>Principal Amount</u>	<u>Date</u>	<u>Principal Amount</u>
March 1, 2014	\$ 640,000	September 1, 2016	\$ 730,000
September 1, 2014	\$ 660,000	March 1, 2017	\$ 755,000
March 1, 2015	\$ 680,000	September 1, 2017	\$ 775,000
September 1, 2015	\$ 695,000	March 1, 2018	\$ 795,000
March 1, 2016	\$ 715,000	September 1, 2018	\$ 815,000

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(8) Long-Term Mortgage Revenue Bonds Payable, continued*

The bonds maturing on September 1, 2021 are subject to mandatory redemption prior to maturity at a redemption price equal to 100% of the principal amount redeemed, plus accrued interest thereon to the date fixed for redemption, from sinking fund installments which are required to be made in amounts sufficient to redeem on the dates specified below the respective principal amount of such bonds specified as follows:

As of September 30, 2002:

<u>Date</u>	<u>Principal Amount</u>
March 1, 2014	\$ 108,434
September 1, 2014	\$ 110,183
March 1, 2015	\$ 113,681
September 1, 2015	\$ 115,430
March 1, 2016	\$ 117,762
September 1, 2021	\$ 119,511

As of September 30, 2001:

<u>Date</u>	<u>Principal Amount</u>
March 1, 2014	\$ 640,000
September 1, 2014	\$ 660,000
March 1, 2015	\$ 680,000
September 1, 2015	\$ 695,000
March 1, 2016	\$ 715,000

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(8) Long-Term Mortgage Revenue Bonds Payable, continued*

The bonds maturing on September 1, 2031 are subject to mandatory redemption prior to maturity at a redemption price equal to 100% of the principal amount redeemed, plus accrued interest thereon to the date fixed for redemption, from sinking fund installments which are required to be made in amounts sufficient to redeem on the dates specified below the respective principal amount of such bonds specified as follows:

As of September 30, 2002

<u>Date</u>	<u>Principal Amount</u>	<u>Date</u>	<u>Principal Amount</u>
March 1, 2022	\$ 114,064	March 1, 2027	\$ 150,915
September 1, 2022	\$ 117,573	September 1, 2027	\$ 156,180
March 1, 2023	\$ 120,498	March 1, 2028	\$ 159,689
September 1, 2023	\$ 124,008	September 1, 2028	\$ 165,539
March 1, 2024	\$ 127,517	March 1, 2029	\$ 170,218
September 1, 2024	\$ 131,612	September 1, 2029	\$ 174,898
March 1, 2025	\$ 135,122	March 1, 2030	\$ 180,162
September 1, 2025	\$ 139,216	September 1, 2030	\$ 186,012
March 1, 2026	\$ 143,311	March 1, 2031	\$ 191,275
September 1, 2026	\$ 147,990	September 1, 2031	\$ 194,200

As of September 30, 2001:

<u>Date</u>	<u>Principal Amount</u>	<u>Date</u>	<u>Principal Amount</u>
March 1, 2022	\$ 975,000	March 1, 2027	\$ 1,290,000
September 1, 2022	\$ 1,005,000	September 1, 2027	\$ 1,335,000
March 1, 2023	\$ 1,030,000	March 1, 2028	\$ 1,365,000
September 1, 2023	\$ 1,060,000	September 1, 2028	\$ 1,415,000
March 1, 2024	\$ 1,090,000	March 1, 2029	\$ 1,455,000
September 1, 2024	\$ 1,125,000	September 1, 2029	\$ 1,495,000
March 1, 2025	\$ 1,155,000	March 1, 2030	\$ 1,540,000
September 1, 2025	\$ 1,190,000	September 1, 2030	\$ 1,590,000
March 1, 2026	\$ 1,225,000	March 1, 2031	\$ 1,635,000
September 1, 2026	\$ 1,265,000	September 1, 2031	\$ 1,660,000

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(8) Long-Term Mortgage Revenue Bonds Payable, continued

The Corporation had expended Bond proceeds and originated loans totaling \$6,249,012 as of September 30, 2002 and 2001, respectively, for which the Trustee had not disbursed such moneys from the Program Fund for the acquisition of Mortgage-Backed Securities.

Pursuant to Article IV, Section 4.02(A)(1) of the bond indenture, the Bonds were subject to special mandatory redemption as a whole, or in part, on November 1, 2001 in an amount equal to the amount transferred from the Program Fund to the Redemption Fund (and amounts transferred from the Escrow Fund and the Capitalized Interest Account in connection therewith), at a redemption price equal to 100% of the principal amount thereof plus accrued interest thereon to the date fixed for redemption, without premium. In addition, pursuant to Article V, Section 5.02(B), on any date prior to October 1, 2001 specified by the Corporation, the Trustee shall transfer amounts on deposit in the Program Fund that the Corporation certifies will not be used to acquire Mortgage-Backed Securities to the Redemption Fund to be applied to the redemption of the Bonds. During 2002, the Trustee exercised and processed that special mandatory redemption and recalled \$44,155,000 due to non-origination of loans.

The Bond Indenture contains certain restrictive covenants, including restrictions on the use of bond funds. Management of the Corporation is of the opinion that the Corporation was in compliance with all significant covenants except for the full non-origination of the entire \$50 million mortgage revenue bond, as of September 30, 2002 and 2001.

(9) Investments and Cash with Trustees

The aforementioned Bond Indenture requires the establishment of special funds and accounts to be held and administered by the Corporation's trustees for the accounting of the monies. At September 30, 2002 and 2001, investments and cash held by the trustees for the Corporation, in these funds and accounts are as follows:

	<u>2002</u>	<u>2001</u>
Program Fund	\$ 6,058,408	\$ 50,082,569
Escrow Fund	16,447	897,853
Capitalized Interest Fund	288,623	285,000
Cash Management Fund	-	-
Revenue Fund	<u>306,027</u>	<u>571,667</u>
	<u>\$ 6,669,505</u>	<u>\$ 51,837,089</u>

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(9) Investments and Cash with Trustees, continued

The Corporation's trustees hold the Corporation's restricted investments and cash at September 30, 2002 and 2001. Investments are stated at amortized cost and accrued interest under a separate balance sheet caption. The carrying value of restricted assets and cash at September 30, 2002 and 2001 are as follows:

	<u>2002</u>	<u>2001</u>
Money Market/Trust Fund	\$ 6,251,036	\$ 51,277,157
U.S. Treasury Notes	<u>418,469</u>	<u>559,932</u>
	<u>\$ 6,669,505</u>	<u>\$ 51,837,089</u>

The market value of restricted investments and cash at September 30, 2002 and 2001 approximates its carrying value.

Under the Governmental Accounting Standards, credit risk associated with investments is categorized into three levels generally described as follows:

Category 1: Insured or registered, or securities held by the Corporation or its agent in the Corporation's name.

Category 2: Uninsured and unregistered, or securities held by a party other than the Corporation and not in the Corporation's name.

Category 3: Uninsured and unregistered, with securities held by a party other than the Corporation and not in the Corporation's name.

The bond funds have been classified as Category 3 investments and the bond reserve funds have been classified as Category 1 investments in accordance with Government Accounting Standards Board (GASB) Statement #3. All other investments held by the trustees at September 30, 2001, have been classified as Category 2 investments.

The Corporation maintains its cash in bank accounts, which at times may exceed federal depository insurance limits. At September 30, 2002 and 2001, \$2,361,585 and \$665,380, respectively, of deposits are covered by federal depository insurance with the remainder being uninsured and uncollateralized.



**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(10) Notes Payable

Notes payable consists of the following:

	<u>2002</u>	<u>2001</u>
Financial institutions:		
Citibank, N.A., 9.625%, payable in monthly installments of \$95,000 including interest, due 2005	\$ 522,356	\$ 1,550,820
Citibank, N.A., 8%, principal and interest payable in monthly installments of \$18,639 plus interest, due 2003	637,041	860,705
Citibank, N.A., 7% principal and interest payable in monthly installments equivalent to payments received from collateralized FHA mortgage loans, due 2003	57,806	176,910
Federal Home Loan Bank of Seattle, 6.99%, payable in monthly installments of \$41,667, plus interest, principal due 2011	-	4,747,126
Federal Home Loan Bank of Seattle, 6.83%, interest payable monthly, principal due 2017	-	2,200,000
Federal Home Loan Bank of Seattle, 6.72%, interest payable monthly, principal due 2017	-	1,000,000
Federal Home Loan Bank of Seattle, 6.60%, interest payable monthly, principal due 2017	-	1,000,000
Federal Home Loan Bank of Seattle, 5.670%, interest payable monthly, principal due 2003	-	1,000,000
Federal Home Loan Bank of Seattle, 6.160%, interest payable monthly, principal due 2008	-	1,463,670
Federal Home Loan Bank of Seattle, 6.090%, interest payable monthly, principal due 2003	480,902	485,951
Federal Home Loan Bank of Seattle, 6.060%, interest payable monthly, principal due 2003	958,851	969,748

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(10) Notes Payable, continued

	<u>2002</u>	<u>2001</u>
Federal Home Loan Bank of Seattle, 6.02%, interest payable monthly, principal due 2003	\$ 963,326	\$ 973,281
Federal Home Loan Bank of Seattle, 5.920%, interest payable monthly, principal due 2003	434,264	438,681
Federal Home Loan Bank of Seattle, 6.490%, interest payable monthly, principal due 2014	9,897,915	-
Government of Guam: 4%, payable in monthly installments of \$107,258 including interest, due 2011 thru 2017	<u>-</u>	<u>13,650,013</u>
	13,952,461	30,516,905
Less current portion	<u>3,769,109</u>	<u>1,946,090</u>
	<u>\$ 10,183,353</u>	<u>\$ 28,570,815</u>

Under the note agreements with Citibank and the Federal Home Loan Bank of Seattle, the borrowings are collateralized by proceeds received from mortgage loans made by the Corporation. As of September 30, 2002 and 2001, the Corporation has pledged as security for these loans approximately \$29,789,397 and \$22,953,176 of related outstanding mortgage loans, respectively.

The Corporation has complied with the covenants of its loan agreements with the financial institutions which provide for, among other requirements, collateral loan ratios, monthly delinquency reports on all loans and periodic submissions of financial statements.

The Corporation defaulted on its Government of Guam loan agreement. In April 2001, pursuant to Section 6 of Guam Public Law 20-210, the Corporation was declared in default on its Government of Guam Revolving Loan Fund ("the Fund") note payable to the Government of Guam that totaled \$13,650,013 as of September 30, 2001. The Corporation has not made monthly payments to the Fund since November 1999, and as such, exceeded the 90-day period after such payments become due for making such payments, which approximated \$517,000 as of September 30, 2001. Accordingly, pursuant to in Section 6 of Guam Public Law 20-210, those amounts payable to the Fund was deferred for the period covering November 1999 to January 2004. In August 2002, the Government of Guam, under Public Law 26-123, passed legislation to forgive the note payable and accrued interest payable of \$13,650,013 and \$517,402, respectively. Consequently, the Corporation recorded a special item as other revenue in 2002 of \$14,167,415 resulting from the debt forgiveness.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(10) Notes Payable, continued

The aggregate maturities of notes payable for the five years ending September 30, 2007, are as follows:

2003	\$ 3,769,109
2004	-
2005	-
2006	-
2007	-
Subsequent years	<u>10,183,353</u>

\$ 13,952,462

(11) Employees' Retirement Plan

Employees of the Corporation hired before September 30, 1995 are under the Government of Guam Employees' Retirement System (a defined, contributory pension plan). Employees hired after September 30, 1995, are members of the New Defined Retirement System (DCRS).

Until 1999, those employees who are members of the defined benefit plan with less than 20 years of service at September 30, 1995, have the option to switch to the Defined Contribution Retirement System. Otherwise, they remain under the old plan. The Defined Benefit Plan and the DCRS are administered by the Government of Guam Retirement Fund, to which the Corporation contributes based upon a fixed percentage of the payroll for those employees who are members of the Plan.

As a result of the most recent actuarial valuation performed as of September 30, 2001, it has been determined that for the year ended September 30 2002, a minimum combined employer and employee contribution rate of 41.24% of covered Defined Benefit Plan payroll is required to appropriately fund the current cost, amortize prior service costs and provide for interest on the unfunded accrued liability. Statutory contribution rates for employee and employer contributions were 9.5% and 19.8016%, respectively, for the year ended September 30, 2002. The effect of the Corporation's prior year accruals for its share of pension underfunding reduces the actuarially determined employer contribution rate from 31.77% to an effective rate of 28.26% for the year ended September 30, 2002. In recognition of the above, an accrual increase of 8.585% of covered payroll is necessary to reduce the unfunded liability based on the difference between the effective rate of 28.26% and the employer's statutory rate of 19.675%. The effective employer accrual rate for the year ended September 30, 2001 was 20.05%.

The plan utilized the actuarial cost method termed "entry age normal" with an assumed rate of return of 7.5% and an assumed salary scale increase of 5.5% per annum for short service employees and 4% per annum for longer service employees.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

*(11) Employees' Retirement Plan, continued*

The most recent actuarial valuation performed as of September 30, 2001, did not provide breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor. If the actuarial valuation were performed for the Corporation as a separate sponsor, the accrued unfunded liability at September 30, 2002 and 2001 may be materially different than that recorded in the accompanying financial statements.

The Guam Legislature enacted legislation during the year ended September 30, 2000, which offered retirement incentives for employees to retire or voluntarily separate from service with the Government of Guam and also required the Retirement Fund to incur the costs of providing certain supplemental retiree benefits. This legislation resulted in a significant increase in the Retirement Fund's unfunded accrued liability and is the primary reason for the increase in the employer's contribution rate for the year ended September 30, 2002.

Contributions into the DCRS by members are based on an automatic deduction of 5% of the member's regular base pay. The contribution is periodically deposited into an individual annuity account within the DCRS. Employees are afforded the opportunity to select from different annuity accounts available under the DCRS.

Employer contributions into the DCRS are based on a statutory amount of 19.8016% of the member's regular base pay. Of the amount contributed by the employer, only 5% of the member's regular base pay is deposited into the member's individual annuity account. The remaining 14.8016% is contributed towards the unfunded liability of the defined benefit plan.

Members of the DCRS who have completed five years of government service, and have attained the age of 55 years at termination, have a vested balance of 100% of both member and employer contributions plus any earnings thereon. Members, who have completed five years of service but have not attained the age of 55, are eligible only for the amount of member contributions plus any earnings thereon.

During 2002, the Government of Guam, as a whole, adopted the provisions of Governmental Standards Board Statement No. 27, *Accounting for Pensions by State and Local Governmental Employees*. The effect of these provisions, which were retroactively applied, is as follows:

	<u>As Originally Stated in 2001</u>	<u>As Restated in 2001 .</u>
Unfunded pension liability	<u>\$ 1,245,248</u>	<u>\$ 208,295</u>
Retirement contributions	<u>\$ 189,369</u>	<u>\$ 138,672</u>
Total net assets at beginning of year	<u>\$13,032,713</u>	<u>\$14,069,666</u>

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(12) Contributions from Government of Guam and Federal Government

In fiscal year 1993 the Government of Guam appropriated \$980,000 from the General Fund to complete the master plan for the development of affordable, market, and special needs housing units. As of September 30, 2002 and 2001, \$187,851 had been expended for the master plan and is recorded in other receivables. The appropriation will be recorded upon the receipt of funds from the General Fund.

On July 6, 1994 the Federal Emergency Management Agency (FEMA) transferred to the Corporation two houses, which were appraised at a market value of \$171,500 on September 23, 1996, and recorded by the Corporation as a contribution. On September 27, 1996, the Corporation sold the houses to GRC for \$171,500 and recorded a contribution from FEMA of an equal amount in the financial statements.

(13) Related Party Transactions

The Corporation is the management agent of the Guam Rental Corporation from which it received a fee of \$144,122 in 2002 and \$194,210 in 2001. The same Board of Directors serves both corporations. (See Note 4 for loan receivable from Guam Rental Corporation.)

As of September 30, 2002 and 2001, a total of \$0 and \$7,325, respectively, is payable to GRC for labor in renovating the main office, and a total of \$138,690 is receivable from GRC for reimbursement of GRC expenses for the As-Atdas project as of September 30, 1996.

In accordance with Public Law 20-225, 46 acres of land were transferred to the Corporation from the Government of Guam upon which to develop affordable housing units for sale to first time homeowners. The units will be sold at cost of construction, plus 2% and \$3 per square meter for the house lot. The donated land was initially recorded at \$2.10 per square meter increased by the cost of the development incurred. Expenditures, net of reimbursements and rental income, related to the development of this property (the Lada Estates Project) amount to \$5,166,953 and \$5,161,603 at September 30, 2002 and 2001, respectively.

The Corporation has a receivable due from the Government of Guam totaling \$2,915,000. Pursuant to Guam Public Law 25-116, the Government of Guam will pay its pro-rata share of costs associated with the Lada Estates Affordable Housing Subdivision Improvement Project Phase I for the design, build and finance of the off-site infrastructure and access roads.

**GUAM HOUSING CORPORATION  
(A PUBLIC CORPORATION)**

Notes to Financial Statements  
September 30, 2002 and 2001

(14) Commitments and Contingencies

The Corporation has a liability payable to a contractor for \$10,555,000 associated with Lada Estates Affordable Subdivision Improvement Project, Phase I for the design, build and finance the on-site infrastructure and off-site infrastructure access roads for the project. The Project was substantially complete on July 24, 1998. The liability is outstanding as of September 30, 2002 and 2001. The contractor is claiming accrued interest of \$3,950,676 and \$2,756,826 is due on the outstanding balance as of September 30, 2002 and 2001, respectively. The Corporation is disputing the amount and its legal counsel believes the contractor's claim may not be payable pursuant to terms of the contract. Therefore, it is not possible to determine the ultimate resolution of this matter and therefore, no provision for any liability that may result from this claim has been made in the financial statements.

The Corporation is the plaintiff in eleven (11) pending claims in which foreclosure, litigation or bankruptcy is involved. These claims are at various stages and the ultimate outcome is uncertain, therefore, no additional provision for any potential liability that may result from these claims has been made in the accompanying financial statements.

As of September 30, 2002 and 2001, the Corporation has a total of \$72,963 and \$125,868 respectively, in loan commitments.

The Government of Guam and its component units, including the Corporation, began withholding and remitting funds to the U.S. Social Security System for the health insurance component of its salaries and wages effective October 1, 1998. Prior to that date, the Government of Guam did not withhold or remit Medicare payments to the U.S. Social Security system. If the Government is found to be liable for Medicare payments on salaries and wages prior to October 1998, an indeterminate liability could result. It has been the practice of the Corporation and all other component units of the Government of Guam that payment of this health insurance component is optional prior to October 1998. Therefore, no liability for any amount, which may ultimately arise from this matter, has been recorded in the accompanying financial statements.

**GUAM HOUSING CORPORATION**  
**(A PUBLIC CORPORATION)**

Supplementary Information

Schedule 1

Salaries, Wages and Benefits  
Years ended September 30, 2002 and 2001

	<u>2002</u>	<u>2001</u>
Salaries, wages and benefits:		
Salaries	\$ 476,306	\$ 1,282,788
Retirement benefits	82,396	138,672
Benefits other than retirement	20,868	58,985
Overtime pay	-	-
Total salaries, wages and benefits	<u>\$ 579,570</u>	<u>\$ 1,480,445</u>
 Employees at end of year	 13	 30

See accompanying independent auditor's report.

**GUAM HOUSING CORPORATION  
(A PUBLIC CORPORATION)**

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**REPORT ON COMPLIANCE AND INTERNAL CONTROL**

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**FOR THE YEAR ENDED SEPTEMBER 30, 2002**



GUAM

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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN AUDIT OF  
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

To the Board of Directors  
Guam Housing Corporation:

We have audited the financial statements of Guam Housing Corporation (a public corporation), as of and for the year ended September 30, 2002, and have issued our report thereon dated August 29, 2003. We conducted our audit in accordance auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether Guam Housing Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, grants, and bond covenants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Internal Control Findings (pages 40 through 59) as items 02-01, 02-02, 02-04, 02-05, 02-10 and 02-11.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Guam Housing Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Guam Housing Corporation's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Internal Control Findings as items 02-01 through 02-11.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level of risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are considered to be material weaknesses. However, of the reportable conditions described above, we consider Findings 02-01, 02-02, 02-03, 02-08 and 02-09 to be material weaknesses.

This report is intended for the information of the Board of Directors, management and the federal awarding agencies and pass-through entities. However, this report is a matter of public record and its distribution is not limited.

*J. Scott Magliari + Company*

August 29, 2003  
Agana, Guam

# GUAM HOUSING CORPORATION

## Schedule of Internal Control Findings Year Ended September 30, 2002

### PART I - SUMMARY OF AUDIT RESULTS

#### Financial Statements

We have audited the basic financial statement of Guam Housing Corporation and issued an unqualified opinion.

Internal control over financial reporting:

- Material weaknesses were identified?      ☒ yes      ☐ no
- Reportable conditions identified that are not considered to be material weaknesses?      ☒ yes      ☐ no
- Noncompliance material to financial statements noted?      ☒ yes      ☐ no

The Guam Housing Corporation did not receive or expend any federal awards for the fiscal year ending September 30, 2002. Therefore, it did not have any major federal program.

### PART II - FINDINGS - FINANCIAL STATEMENTS

We noted certain reportable conditions and instances of noncompliance be reported in accordance with Government Auditing Standards that are presented in the following pages as items 02-01 through 02-11.

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
02-01	Employee Loans	\$ -
02-02	Loans Receivable	-
02-03	Loans Receivable	-
02-04	Loans Receivable	-
02-05	Loans Receivable	-
02-06	Loans Receivable	-
02-07	Loans Receivable	-
02-08	Allowance for Loan Loss	-
02-09	Land Held for Development/ Accounts Payable	-
02-10	Trust Fund	-
02-11	Trust Fund	-
		<u>          </u>
		<u>\$ -</u>

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-01 Criteria:

All loans to employees of Guam Housing Corporation shall be made in compliance with the Corporation's underwriting guidelines. No preferential treatment based on loan conditions, rates, terms, collateral, and qualification standards shall be permitted. Any exception to standard underwriting policy and procedure must be fully documented and approved by the Board of Directors.

#### Condition:

The Corporation has twelve (12) outstanding loans made to employees. Of those loans, six (6) employee loans were non-performing and delinquent as of September 30, 2002, as follows:

<u>Loan No.</u>	<u>Days O/S</u>	<u>Loan Balance</u>	<u>Accrued Interest</u>
79402281	371	\$ 10,262.16	\$ 1,206.12
859402281	364	101,579.02	6,022.82
859002011	229	92,640.03	3,476.37
79002011	260	4,378.15	369.09
59802412	146	169,587.59	4,031.30
59702367	213	<u>118,640.93</u>	<u>4,113.13</u>
Total		<u>\$ 497,087.88</u>	<u>\$ 19,218.83</u>

Additionally, two of the above loans were granted to employees under the 1113 Loan Program in an effort to assist those employees to bring their loans current. One of the requirements of the 1113 Loan Program requires evidence to demonstrate positive repayment ability by the borrower. However, those loans were also delinquent as of September 30, 2002.

#### Cause:

The Corporation is not adhering to its loan policies and procedures to ensure that employee loans are serviced in accordance with its collection policy.

#### Effect:

The effect of the above condition is the possibility of an ineffective method for determining the allowance for loan losses and consequently the Corporation may have some level of credit risk in its loan portfolio.

## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-01 Recommendation:**

We recommend that the Corporation take corrective action to enforce its loan servicing policy and procedures and in the event that such delinquent loans and can not be brought back to a performing status, we recommend that the loans be subject to foreclosure proceeding as a last resort to cure the loan default. Additionally, the 1113 Loan Program funds should only be extended to borrowers for the specific purpose of bringing existing residential loans current to per performing status.

#### **Auditee Response/Corrective Action Plan:**

The Loan Administrator provides a status report of all employees' loans every board meeting. The President has access to the Mortgage Servicer and can view each account. A loan servicing committee comprised of the Collection Agent, Loan Administrator, Quality Assurance Officer and the Manager will review each employee loan in arrears with a recommendation for servicing.

Currently two of the accounts which are delinquent are with the corporation's legal counsel for foreclosure/bankruptcy proceedings.

79402281 & 85902281 – referred to Legal Counsel on 9/25/03  
79002011 & 85902011 – referred to Legal Counsel on 7/17/03

#### **02-02 Criteria:**

The Corporation shall ensure that the use of loan re-amortizations, extensions, deferrals, refinancing, re-casting are based on a borrower's willingness and financial ability to repay the loan, and that they are structured in conformance with existing underwriting guidelines. The use of loan re-amortizations, extensions, deferrals, refinancing, or re-casting shall be limited to no more than once in a twelve (12) month period and no more than twice in a three-year period unless approved by the Board of Directors.

The request for deferral, not to exceed 3 months, must be made in-writing by the borrower and must demonstrate that the reason for deferral is due to circumstances beyond the borrower's control. The borrower's situation must be temporary, and the borrower must demonstrate the ability to resume monthly payments and cure the delinquency no later than the next due date after the expiration of the deferral.

# GUAM HOUSING CORPORATION

## Schedule of Internal Control Findings Year Ended September 30, 2002

### 02-02 Condition:

As of September 30, 2002, the Corporation's loan portfolio included 18 deferred loans outstanding totaling \$1,308,840 with accrued interest approximating \$107,273. Of those deferred loans, 8 or 44% exceeded the maximum three month extension and based on our review of the subsequent payment history and review of each borrower's loan file, the loans were not brought current to cure the delinquency nor was there any documentation on-file to evidence any further action by the taken by the Corporation for the following deferred loans:

Loan Number	Days Outstanding	Loan Balance	Deferred Accrued Interest
818201308	107	\$ 35,491.40	\$ 4,732.60
819001943	530	19,353.76	4,419.44
819302215	121	117,486.84	11,956.54
819702352	237	100,097.81	7,505.95
859002034	505	96,329.81	11,067.35
859002011	229	92,640.03	7,086.90
859402281	364	101,579.02	8,161.89
859402293	182	81,986.15	2,003.69
	Total	<u>\$ 644,964.82</u>	<u>\$ 56,934.36</u>

### Cause:

The Corporation did adhere to its established loan policies and procedures for administering deferred loans. Therefore, this condition appears to indicate a lack of internal controls over loan credit monitoring and collection and internal loan review activities.

### Effect:

The potential exist for borrowers to default on the above-mentioned deferred loans and not be able collect the deferred accrued interest

# **GUAM HOUSING CORPORATION**

## **Schedule of Internal Control Findings Year Ended September 30, 2002**

### **02-02 Recommendation:**

We recommend that the President, in conjunction with the Loan Administrator, adhere to the Corporation's internal control loan underwriting policies and procedures for administering deferred loans. We recommend that Loan Officers commence efforts to contact all such borrowers to move all deferred loan to a performing status. In an effort to mitigate the Corporation's exposure to collateral risk, updated information should be obtained on the collateral supporting the loan, to include an updated appraisal report, a preliminary title report and updated financial information on the borrower. Should it be determined that the above outlined borrowers are unable to cure the delinquency, foreclosure proceeding should commence.

### **Prior Year Status:**

No formal approved written underwriting policies and procedures for granting approval of deferred loans and a lack of internal controls over loan credit monitoring and collection and internal loan review activities were reported as finding in the audit of the Corporation for the fiscal years ending September 30, 2001, 2000 and 1999.

### **Auditee Response/Corrective Action Plan:**

This type of servicing was discontinued. The loan administrator will seek legal advice on additional servicing actions to be taken by GHC. There were 27 loans with this type of servicing category, 18 remain with balances outstanding in the amount of \$95,503.51 as of December 2003.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-03 Criteria:

Loans should be properly monitored to minimize credit risk and to identify delinquent loans and potential foreclosures in a timely manner.

#### Condition:

Loans in arrears three months or more including those referred to the Corporation's attorney for collection totaled \$6,255,612 and \$4,540,609 for the years September 30, 2002 and 2001, respectively. This translates to an increase in delinquent loans of \$1,715,003 or 37% over the prior year. Consequently, the Corporation's delinquency rate increased to 17% as compared to 11% for fiscal year 2001.

Based on our review of certain loan files, there was no documentation available in the borrowers' file to evidence that a loan evaluation and review was conducted to indicate that the collateral value was higher than the potential loan loss. Consequently, this condition appears to indicate there is a potential credit risk and eventual foreclosure on these loans.

#### Cause:

The Corporation did not adhere to its established written policies and procedures for identifying and servicing delinquent loans in a timely manner. Additionally, it appears that the Corporation's loan servicing and collection policies and procedures may still be ineffective or not properly adhered to.

#### Effect:

The potential exist for these loans to become uncollectible and subsequently foreclosed in the near term. Additionally, the above condition negatively impacts the Corporation's cash flow from its inability to collect principal and interest on delinquent loans in a timely manner.

#### Recommendation:

We are cognizant that the Corporation has implemented a Recover Action Plan and conducted a review of its loan portfolio and its existing loan underwriting, servicing and collection policies, and procedures. However, we recommend that the Corporation re-evaluate its collection and loan servicing policies and procedure to determine areas of improvement and staff assigned to perform such functions.



## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-03 Recommendation: (continued)

Accurate monthly past due loan reports be should generated and reviewed promptly to identify potential delinquent accounts once they become 30-days past due and aggressively pursue payments from such borrowers to help control credit risk.

We recommend that the Corporation establish an internal loan review function independent of origination, disbursement, servicing, accounting, monitoring, and collection functions. The loan review function may be performed by a committee of the Board of Directors or employees of another department. The objectives of internal loan reviews are to: 1) monitor compliance with established lending policies; 2) assess whether the payments due on the loan are likely to be received in accordance with the loan terms; and 3) identify weaknesses in the lending process or the lending officers' skills in originating, monitoring, servicing and collecting loans.

#### Prior Year Status:

Loans in arrears three months or more including those referred to the Corporation's attorney for collection and loan servicing was reported as finding in the audit of the Corporation for the fiscal year 2001, 2000 and 1999.

#### Auditee Response/Corrective Action Plan:

For fiscal year 2002, GHC forwarded 33 accounts to its legal counsel. Most of the referred accounts had little or no action taken by the previous Legal Counsel. The loan administrator expressed concern to the Board; however the Board of Directors opted not to take any action.

GHC has revised its servicing and collection policies and training was conducted in March 2003. A servicing committee has been formed and further review will be made to determine further servicing action prior to referral to legal counsel.

## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-04 Criteria:**

A Release of Mortgage should be executed to ensure that borrowers and the Corporation and debt secured by the mortgage has been fully paid, satisfied, released and discharged, and that the property secured thereby has been released from the lien of such mortgage.

#### **Condition:**

For five (5) or 9% of the loan files tested, property was subject to another mortgage for which the files did not contain any documents supporting its release for loan numbers 19001983, 19702382, 38501561, 38601596 and 59102089.

We also noted that a Partial Release of Mortgage was initiated for loan number 19802440; however, there is no documentation on file to indicate that such was filed with the Department of Land Management.

#### **Cause:**

There appears to be a lack of internal controls and procedures to ensure that borrowers and the Corporation and debt secured by a mortgage has been fully paid, satisfied, released and discharged, and that the property secured thereby has been released from the lien of such mortgage.

#### **Effect:**

The potential exist for properties used by borrowers as collateral may not wholly-owned and not secured by the Corporation.

#### **Recommendation:**

The Corporation should obtain a Release of Mortgage for properties used as collateral for loans to the above listed borrowers and file such with the Department of Land Management. Internal control policies and procedures should be adhered to ensure that all loan applications are properly documented and processed in accordance with the Corporation's existing underwriting policy and that all loan documentation is properly maintained in the borrower's loan file.

# GUAM HOUSING CORPORATION

## Schedule of Internal Control Findings Year Ended September 30, 2002

### 02-04 Auditee Response/Corrective Action Plan:

For those loans lacking documentation, the following action was taken:

19001983 – Loan has been satisfied in-full on 3/6/03.

19702382 – Release recorded on 9/5/03.

38501561 – Release received on 11/18/03.

38601506 – GHC will continue its efforts to obtain release from the lending institution, which purchased American Savings portfolio.

59102089 – Loan was paid off by GHC and documents were given to borrower for recordation. Another release will be prepared if original is not recorded.

19802440 – Release obtained on 2/19/03 and is on-file.

GHC will review each policy prior to payment of policy. A letter to Title Company will be given emphasizing GHC's instructions regarding clearing all exceptions before recordation of mortgage.

### 02-05 Criteria:

The Corporation shall require hazard insurance sufficient to cover 100% of the replacement value of all improvements, or the unpaid balance of the loan, whichever is less. In no case shall the amount of insurance coverage be less than the principal loan balance.

#### Condition:

For five (8) or 9% of the loan files tested, a current copy of the borrower's hazard insurance policy was not on file for the following loans:

#### Loan Number

19702351

59002009

19802425

819001981

859002034

#### Cause:

There appears to be a lack of internal control with regards to the documentation of insurance policies for the loan files.

# **GUAM HOUSING CORPORATION**

## **Schedule of Internal Control Findings Year Ended September 30, 2002**

### **02-05 Effect:**

The properties are not properly insured and the Corporation has assumed additional collateral risk.

### **Recommendation:**

The Loan Officer should obtain copies of the borrower's hazard insurance policy ensuring that such coverage is sufficient to cover 100% of the replacement value of all improvements, or the unpaid balance of the loan, whichever is less. Additionally, the Loan Administrator should ensure that the Corporation's hazard insurance coverage policy is adhered to by the Loan Department.

### **Auditee Response/Corrective Action Plan:**

The following action was taken on the above-mentioned loans:

19702351 – Both 2002 and current policies are now on-file.

59002009 – Insurance advised GHC that company overlooked renewal and Policy was not renewed. Borrower opted to obtain policy elsewhere; however, the current policy is now on-file.

19001981 – Current policy is on file.

19802425 – Policies for 12/01-12/02 and year are now on-file.

859002034 – Policy will be obtained upon acceptance of conveyance.

GHC has created a central filing system for easy access and maintenance of policy filing. Trust Fund Technician at time of payment reviews each policy, completes a checklist and updates tickler card. A letter is given to each borrower advising of any changes necessary on monthly trust fund payment to ensure adequate balance for payment of insurance and taxes when due.

Loan Technician will assist in sending monthly notices to all borrowers whose policies will expire within two months.

## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-06 Criteria:**

The Corporation should maintain an updated database on all borrowers.

#### **Condition:**

Based on our audit of loan balances, we noted that five (5) or 2% of the loan confirmation letters sent to borrowers were returned by the Post Office with the wrong address. Upon inquiry with the Corporation's Data Processing and Loan Divisions, current addresses were not available. This condition has not been properly corrected for over five years.

As a result, monthly loan statements and related correspondence sent out to borrowers may not be received. We were able to review the transaction history of the accounts and other related documentation to substantiate the validity of the accounts and the correctness of the borrowers' loan balances; however, certain accounts were delinquent and indicative of collection problems.

#### **Cause:**

The Loan Department along with Data Processing Department has not established internal control policies and procedures to ensure that an updated and current database is maintained for borrowers.

#### **Effect:**

The lack of a current borrower database has the potential to negatively impact the Corporation's ability to collect on delinquent loans if it is not able to adequately contact such borrowers in a timely manner to cure delinquent account balances.

#### **Recommendation:**

We recommend that Corporation review and update borrower information currently maintained in its database. Borrowers should be contacted by whatever means available to obtain current addresses and other vital information and loan files and borrower databases should be updated accordingly.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-06 Prior Year Status:

Failure to develop written internal control policies and procedures for maintaining an updated and current database for borrowers was reported as a finding in the Corporation's audit for the fiscal years ending September 30, 1999 through 2001.

#### Auditee Response/Corrective Action Plan:

Upon receipt of returned mail, borrowers are contacted to obtain updated information. If unable to reach, Loan Technician will check credit bureau for updated information. Upon relocation to permanent office, Loan Technician will have access to credit bureau.

Will coordinate with Data Section to ensure names are provided to loan division upon receipt of returned mail.

#### 02-07 Criteria:

Loan files should be maintained in an orderly and systematic manner to ensure that all documentation obtained and filed can be independently verified.

#### Condition:

The Corporation utilizes a document checklist for obtaining borrower information and maintaining loan files. The loan file checklist form is not being properly used. Documents are not being filed in accordance with the index on the checklist and in certain files; documents were loosely kept in the loan files. In 26 of 60 or 43% of the loans tested, tasks were initialed as being completed or documents obtained when in fact, such had not been completed.

#### Cause:

The cause of the above condition is the lack of adherence to existing internal control policies and procedures to ensure that all loan files are reviewed for proper documentation prior to loan approval.

#### Effect:

The potential exist for loans to be improperly approved and for documents to be lost or misplaced.

## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-07 Recommendation:**

Loan files should be properly reviewed to ensure that all documents have been obtained prior to loan approval and disbursement of funds. All tasks performed should be initialed as completed by the responsible individual to ensure that the task was completed. Additionally, the filing of documents as indexed on the loan file checklist will not only enhance efficiency but also reduce the likelihood of missing documents. For example, loan file contents could be categorized and arranged by credit investigation, application, supervision section, loan servicing, and loan documentation section with subcategories for each section.

#### **Prior Year Status:**

The lack of proper loan file management and documentation was reported as finding in the Corporation's audit for the fiscal years ending September 30, 2001, 2000 and 1999.

#### **Auditee Response/Corrective Action Plan:**

Loan Technician has conducted an inventory of all files and has organized filing cabinets. Each loan employee has been given assignments for file maintenance and an assigned day for filing.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-08 Criteria:

Statement on Financial Accounting Standards No. 5, *Accounting for Contingencies*, Statement on Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, as amended, and the provisions of Statement on Financial Accounting Standards No. 118, *Accounting for by Creditors for Impairment of a Loan - Income Recognition and Disclosure* are the primary sources of guidance on accounting for the allowance for loan losses and for impaired loans.

An allowance for loan losses should be maintained at a level, which, in management's opinion, is adequate to absorb credit losses inherent in the loan portfolio. The amount of the allowance should be based on an evaluation of the collectibility of the loan portfolio, including the nature of the portfolio, credit concentrations, trends in historical loss experience, specific impaired loans, economic conditions, and other risks inherent to the loan portfolio. When a loan is deemed impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, if the loan is considered to be collateral dependent, based on the fair value of the collateral. The allowance should be increased by a provision for loan losses, which is charged to expense and reduced by charge-offs, (net of recoveries). Changes in the allowance relating to impaired loans should be charged or credited to the provision for loan losses.

#### Condition:

The Corporation lacks formal written internal control policies and procedures to evaluate loans for potential loss. The Corporation has not performed a detailed review or assessment of collateral value of its non-performing loans to determine its credit and collateral risks should such loans result in foreclosure. Based on our review of the loan portfolio, this amount may not be sufficient for potential credit risk as of September 30, 2002.

#### Cause:

The Corporation has not established written policies and procedures for determining the allowance for loan losses based on accounting principles generally accepted in the United States of America.



## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-08 Effect:**

The effect of the above condition is the possibility of an ineffective method for determining the allowance for loan losses and consequently the Corporation may have some level of credit and collateral risk in its loan portfolio.

#### **Recommendation:**

The Corporation should formally document its policies and procedures for determining loan losses and ensure that an adequate allowance for loan loss is maintained to absorb credit losses and impaired loans in accordance with SFAS Nos. 114 and 118. The allowance for loan loss should be maintained at a level, which in management's judgment should be sufficient to absorb credit losses inherent in the loan portfolio. The amount of the allowance should be based on management's documented evaluation of the loan portfolio, including the nature of the portfolio, the borrower's ability to repay their obligations according to contractual terms of the loan agreement, trends in historical loss experience, specific impaired loans, economic conditions, and other risks inherent in the portfolio.

The collateral value of existing non-performing loans should be properly assessed inclusive of obtaining updated property appraisals, as original appraisals may be too old and not indicative of current market values.

#### **Prior Year Status:**

The lack formal written internal control policies and procedures to evaluate loans for potential loan loss was reported as finding in fiscal years 1999 through 2001.

#### **Auditee Response/Corrective Action Plan:**

As recommended by the Auditor, all loans over 30 days delinquent will be reviewed to determine Corporation's risk and potential loss. Currently only loans over 90 days have been reviewed and reported to the Board for adjustments to Allowance for Loan Loss Reserves.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-09 Criteria:

The Lada Estates Affordable Subdivision Improvement Project ("Project") was designed to provide affordable housing units. The Government of Guam transferred 46 acres of land to the Corporation upon which to develop affordable housing units for sale to first time homeowners. The Corporation has a contract with a certain contractor for project development. The contract states that the Corporation will pay the contractor within ninety days upon completion and acceptance of all work.

#### Condition:

Phase I of the project has been completed; however, the Corporation has not been able to obtain a contractor to complete Phase II of the development project. The Phase II project requires the developer build the housing units and to be responsible for the marketing and sale of such housing units and has the obligation to pay for the cost of Phase I of the project. Ultimately, this cost will be borne by the homebuyer on Phase II of the project. Based on the land development cost incurred to-date, the decline in market demand for single-family homes, private market competition, and a weak economy in the Territory of Guam, the project has stalled and no continued development has taken place.

The Corporation has a contractual liability payable to the contractor totaling \$10,555,000 for the cost associated with the Project. The contractor's work was substantially complete on July 24, 1998. The contractor is seeking payment plus an additional \$3,950,676 as interest charges for non-payment of the contract amount that is being disputed by the Corporation.

#### Cause:

The Corporation was not able to obtain sufficient qualified buyers for the Project and was not able to successfully bid out and obtain a qualified contractor for the completion of Phase II of the project in a timely manner. The Corporation contends that payment to the contractor is contingent upon the obtaining a contractor to complete Project Phase II; however, the Corporation has ceased its efforts in this project development.

#### Effect:

The Corporation does not have the funds to pay the amounts due to the contractor and the potential exist whereby the Corporation may be liable for interest charges of \$3,950,676. No adjustment has been made to the Corporation's financial statements for this contingent liability as September 30, 2002.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-09 Recommendation:

We recommend that the Corporation seek legal counsel advice to determine who is ultimately responsible for payment of the \$10.5 million payable to the contractor and seek advice on the disputed amount of \$3.9 million in interest claimed by the contractor. Furthermore, the Corporation should decide if the project remains viable and should be continued.

#### Prior Year Status:

The Project completion and non-payment of contractual amount and related interest payable was reported as finding for the fiscal years 2001 and 2000.

#### Auditee Response/Corrective Action Plan:

Upon the advice of counsel and in light of current litigation filed against GHC by Maeda Pacific Corporation on this issue, we refrain from any discussion or commentary. Additionally, the FY2002 Audit should reflect the status of the project for that specific year and not the current planned disposition of this matter. Our records reflect no activity on the Lada project during FY2002.

#### 02-10 Criteria:

The Corporation is required to establish a trust fund for all residential mortgage loans. The Corporation shall collect real estate taxes and hazard insurance premiums sufficient and available to pay the borrower's annual real estate taxes and insurance premiums. Once these funds are placed in the trust fund, the Corporation is responsible for the payment of such taxes and premiums. Additionally, all trust fund accounts must be reviewed annually, at which time, the borrower may be required to increase their monthly obligation if costs associated with their real estate property tax or hazard insurance premium increase, or the borrower may receive a refund if the same costs decrease. If the trust fund account has excess funds, the borrower will be given the option to leave the funds in the account; receive the excess funds; or reduce the trust fund assessment in increments over the subsequent twelve-month period.

#### Condition:

For two (2) or 4% of the loan files tested, there were no property tax billing on file to evidence that property taxes were paid for tax year 2001 for loan numbers 10002672 and 59702388.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

02-10 Cause:

There appears to be a lack of internal control policies and procedures to ensure the Trust Fund Clerk obtain and paid the real estate property taxes in a timely manner.

Effect:

Real property taxes were not paid. Additionally, monies held in the trust fund may not be properly managed and disbursed by the Trust Fund Clerk.

Recommendation:

The Loan Administrator should require the Trust Fund Clerk to determine whether property taxes due for the tax year 2001 were paid for the above listed borrowers and cure the tax liability accordingly and adhere to internal control policies and procedures to ensure that all documentation is maintained for payment of taxes and insurance.

Auditee Response/Corrective Action Plan:

Upon receipt of all tax billings, Trust Fund Technician will review and identify those properties with no billing received from Department of Revenue and Taxation. A request for those billings will be made immediately before the payment due date.

## GUAM HOUSING CORPORATION

### Schedule of Internal Control Findings Year Ended September 30, 2002

#### 02-11 Criteria:

The Corporation is required to establish a trust fund for all residential mortgage loans. The Corporation shall collect real estate taxes and hazard insurance premiums sufficient and available to pay the borrower's annual real estate taxes and insurance premiums. Once these funds are placed in the trust fund, the Corporation is responsible for the payment of such taxes and premiums.

Additionally, all trust fund accounts must be reviewed annually, at which time, the borrower may be required to increase their monthly obligation if costs associated with their real estate property tax or hazard insurance premium increase, or the borrower may receive a refund if the same costs decrease. If the trust fund account has excess funds, the borrower will be given the option to leave the funds in the account; receive the excess funds; or reduce the trust fund assessment in increments over the subsequent twelve-month period.

#### 02-11 Condition:

Based on our review of the Corporation's reconciliation of the escrow/trust fund balances on the loans receivable trial balance, we noted 104 or 15% of the Corporation's loan portfolio had debit balances totaling \$139,883 representing amounts paid by the Corporation on behalf of and due from borrowers. The individual amounts from borrowers ranged from \$100 to \$8,998. Based on our inspection of the loan files, no documentation was on-file to evidence that repayments arrangements were in effect or any other correspondence to indicate that the respective borrowers were properly notified to cure amounts in arrears.

#### Cause:

There appears to be a lack of internal control policies and procedures to ensure that all real property taxes and insurance payments are collected in advance from borrowers in a timely manner prior to the respective due dates.

#### Effect:

The Corporation is financing borrowers' real property tax and insurance payments which is negatively impacting the Corporation's operations and cash flow position.

## **GUAM HOUSING CORPORATION**

### **Schedule of Internal Control Findings Year Ended September 30, 2002**

#### **02-11 Recommendation:**

We recommend that the Corporation adhere to its internal control loan policies and procedures to ensure that all real property taxes and insurance payments are collected in advance from borrowers, in a timely manner. The Trust Fund Clerk should contact each such borrower and arrange to cure the amount in arrears. Monthly reports should be prepared by the Trust Fund Clerk and submitted to Loan Administrator and Loan Servicing personnel to follow up with borrowers for any deficiency in their trust fund account.

#### **Prior Year Status:**

The lack of adherence internal control loan policies and procedures to ensure that all real property taxes and insurance payments are collected in advance from borrowers in a timely manner prior to the respective due dates was reported as finding in the 2001 and 2000.

#### **Auditee Response/Corrective Action Plan:**

The Corporation has an approved a policy relative to the serving over-drawn Trust Fund accounts. Because its policy requires payment for real property taxes and hazard insurance policies, it may result in over-drawn borrower trust fund accounts. In the event an account becomes over-drawn, the Corporation will send a notification to borrower(s) advising them to bring their respective accounts current. Borrowers failing to respond to such notification will be sent a final demand letter. For borrowers failing to respond or take action within two (2) weeks, their accounts will be referred to legal council for appropriate action.