INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT 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, 2000, and have issued our report thereon dated April 17, 2001. We conducted our audit in accordance with generally accepted auditing standards 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 my 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 3 through 25) as items 00-1 and 00-2.

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 00-1 through 00-14.

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 00-1, 00-2, 00-3, 00-4, 00-5 and 00-6 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.

April 17, 2001

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-1 Criteria:

The Corporation is required to make monthly payments to the Government of Guam's Revolving Loan Fund ("the Fund") in a timely manner and comply with the covenants of the loan agreement.

Condition:

The Corporation has not made payments on its notes payable of $13,650,000 due to the Fund since November 1999 resulting in an arrears balance approximating $517,000. Additionally, during fiscal year 2000, the Corporation had attempted to consolidate the individual notes payable to the Fund and restructure the note including the waiver of interest payments for a specified period; however, it was not consummated. The Corporation's legal counsel along with the Government of Guam's Attorney General are reviewing alternatives to amend the existing loan to provide repayment of the debt.

Cause:

The Corporation has sustained recurring negative cash flows and has an increased number of delinquent and non-performing loans that have negatively impacted the Corporation's ability to make new loans and meet it's current obligations.

Effect:

The Corporation is in noncompliance with the loan covenants and defaulted on the note payable; however, the Governor of Guam deferred those amounts payable until January 2004. This condition also contributed to the issuance of a going-concern opinion on the financial statements.

Recommendation:

We are aware of the adoption and implementation of the Corporation's Recovery Action Plan that requires, among others, the deferment of its Fund obligations until January 2004. However, we strongly recommend that the Corporation fully implement the Recovery Action Plan and meet with the Department of Administration to negotiate or amend the existing note payable to the Fund expeditiously. We further recommend that the Corporation meet with each of its financial lending institutions to either restructure or refinance existing debt obligations to facilitate its current and future cash flow requirements.

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-1 Auditee Response/Corrective Action Plan:

This issue has been addressed.

Though GHC has been referenced for non-payment of equal monthly payments to the Revolving Loan Fund (RLF), neither did the RLF make monies available to draw on for new loans during this period. Because of actions by the GHC and the custodian of the RLF (the Guam Department of Administration) initiated and approved by both parties payments to this account covering the interim from February 2000 through May of 2001 were deferred. Subsequently payments on the RLF notes by the GHC have been deferred through January 2004. As of March 2001, all funds realized from loans that the GHC made from notes issued by this account are placed in a separate account to be used for processing new loans under the same terms as the RLF-based loans. These initiatives may be addressed in the final report and subsequently should resolve this issue.

The GHC currently does not have an agreement with the Department of Administration to amend the existing note and does not believe that this is a pressing matter since the deferment was based on the statutory authority of the Governor of Guam.

The GHC has met with other creditors and is in the process of discussions about the restructuring and/or refinancing of these obligations. These discussions have precipitated an exhaustive review of the GHC's loan files, contributing to issues raised in Findings 00-9, 00-10 and 00-12.

00-2 Criteria:

In accordance with Bond Indenture, the Corporation's $50 million mortgage revenue bonds are subject to early redemption or a non-origination call if such bond proceeds are not fully expended no later than November 1, 2001. Pursuant to Article V, Section 5.02(B) of the Bond Indenture, on any date 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.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-2 Condition:

As of September 30, 2000, the Corporation had only originated loans totaling $2,164,475 for which the Trustee had not disbursed such moneys from the Program Fund for acquisition of Mortgaged-Backed Securities. As of April 2001, the Corporation had originated loans approximating $5 million; consequently, it appears that the Corporation will have to remit unexpended bond proceeds due to loan non-origination.

Cause:

The cause of this condition appears to be due to the Corporation's inability to attract qualified applicants, a declining real estate market in the Territory of Guam and excess affordable housing.

Effect:

The effect of the above condition is that the Corporation will forfeit $1 million deposited into an escrow fund administered and maintained by the Bond Trustees. The Corporation's early redemption of the mortgage revenue bonds may adversely effect the Territory of Guam's bond rating.

Recommendation:

We are aware of the adoption and implementation of the Corporation's Recovery Action Plan, which calls for, among others, fully expending the proceeds from the mortgage revenue bonds. However, we strongly believe that the Corporation will not be able to meet this objective as outlined in the Recovery Action Plan. Therefore, we recommend that the Corporation commence arrangements with the Trustee to comply with Article V, Section 5.02(B) of the Bond Indenture.

Auditee Response/Corrective Action Plan:

Preparations to address the non-origination call are being addressed in relation to critical dates and decisions.

The factors surrounding the non-origination call relative to the bond are primarily factors of Guam's economic condition coupled with the market environment; neither of which were favorable to full use of the bond proceeds in the prescribed period.

00-2 Auditee Response/Corrective Action Plan: (continued)

As of this date approximately six million dollars in mortgages have been written against these proceeds and settlement is progressing with Freddie Mac. Five million dollars of these loans are expected to close accordingly prior to month's end.

In late June, the GHC acting Chair, acting President and acting Manager met with the Bond Underwriter and discussed specific processes to be employed with respect to the non-origination call on the bond and to assure that Master Servicer arrangements are finalized. Neither the GHC nor the Bond Underwriter believe that the non-origination call on this Bond will have any lasting effect on the Territory of Guam's bond ratings.

00-3 Criteria:

Financial lending institutions should design their lending activities to control and manage the lending risks e.g., credit risk, collateral risk, concentration risk, management or operational risk, and fraud risk. Those activities can generally be classified into the following categories:

a. Originating and disbursement
b. Servicing and accounting
c. Credit monitoring and collection
d. Internal loan review
e. Loan evaluation

Condition:

The Corporation's loan portfolio includes loans due from borrowers categorized as Deferred Loans. These are loans whereby the borrower requests, in writing, that loan payments be deferred for a specified period of time. As of September 30, 2000, there were 21 deferred loans outstanding totaling $1,632,131 with an aggregate deferred accrued interest approximating $130,984. There are no formal approved written underwriting policies and procedures for granting approval of deferred loans. Therefore, this condition appears to indicate a lack of internal controls over loan credit monitoring and collection and internal loan review activities.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-3 Cause:

The Corporation has not established and implemented internal control underwriting policies and procedures for granting deferred loans.

Effect:

There is no effect on the financial statements; however, the potential exist for the borrowers to default on the above-mentioned deferred loans and the uncollectiblity of the deferred accrued interest.

Recommendation:

We recommend management establish internal control loan underwriting policies and procedures for granting approval of deferred loans. Deferred loan policies and procedures should consider credit and collateral risk. Credit risk is the risk that the borrower will not repay the loan and the lender will not recover the amount of the loan. Collateral risk can be considered an aspect of credit risk because it can directly affect the risk of credit loss relating to the loan. Collateral risk is the risk that a loss will be incurred on secured loans because of circumstances such as the value of the collateral has declined significantly, among others.

We recommend that management obtain the Board of Directors approval prior to the deferment of any loan.

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 year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

The GHC's policy no longer provides for deferred loans.

The issue regarding deferred loans was addressed in the previous year's audit. It was suggested at the time that a policy be initiated to set the parameters for the program. The GHC's position, however, was for discontinuance.

00-3 Auditee Response/Corrective Action Plan: (continued)

It is important to note that such a program is permissible according to industry standards but was not well received by the customer or the industry with whom our loans have been pledged. There was no additional activity in this program in fiscal year 2000 since GHC policy was subsequently changed during fiscal year 2000.

00-4 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 $10,166,700 for the year September 30, 2000, which translates to an increase in delinquent loans of $3,618,297 or 55% over the prior year. Consequently, the Corporation's delinquency rate increased to 24% for fiscal year as compared to that of 15% and 11% for fiscal years 1999 and 1998, respectively, which indicates a deteriorating quality of the Corporation's loan portfolio.

At September 30, 2000, the principal, interest, and late fees and other charges due from borrowers on those delinquent loans approximated $1,346,898 for 190 loans of which, 75 loans are outstanding in excess of 12 months. 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. Additionally, it appears that the Corporation's loan servicing and collection policies and procedures are ineffective or not properly adhered to.

Cause:

The Corporation did not adhere to its established written policies and procedures for identifying and servicing delinquent loans in a timely manner.

00-4 Effect:

The effect of the above condition is the possibility of an ineffective method for determining the allowance for loan losses. The potential exist for certain of the Corporation's loans to become collectible 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's management has implemented a Recover Action Plan, which includes a thorough review of its loan portfolio to determine alternative solutions to cure delinquency short of foreclosure. The Corporation should also conduct a thorough review its existing loan underwriting, servicing and collection policies, and procedures to establish and amend such through Board approval in order to strengthen such policies.

Accurate monthly past due loan reports should generated and reviewed promptly to identify potential delinquent accounts once they become 30-days outstanding and aggressively pursue payments from such borrowers to help control credit risk. Poorly designed or ineffective servicing and accounting activities can contribute to increased risk in areas besides credit risk, such as fraud, insider, operations, or management risk.

Loan evaluation is the process used to determine the allowance for loan losses. Therefore, 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.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-4 Prior Year Status:

Loans in arrears three months or more including those referred to the Corporation's attorney for collection was reported as finding in the audit of the Corporation for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

The GHC is aggressively addressing delinquent loans in a variety of ways as an on-going activity in the process of recovery and reorganization.

Guam's general economic condition has impacted all financial institutions and their delinquency ratios. The GHC is no exception and as a lender of last resort might be anticipated to be effected to a greater extent than other home mortgage providers.

The overall economic decline, however, has caused us to revisit the manner in which we address our accounts, including debt restructuring, evaluation of payment schedules relative to early payment of principal by borrowers, enhanced follow-up and serving by the loan department and homeownership counseling. The results in this effort have been promising as is evident by current delinquency rates. As a result of these actions, the dollar value of loans in arrears and those referred to counsel are significantly less than noted in the audit.

In July the GHC awarded a contract to review and prepare reports on the Corporation's portfolio covering; all past due residential mortgage loans, accounts at legal, the soundness of underwriting procedures based on a 20% sample of residential mortgage loans issued for dwelling purchase and a similar review of mortgage loans issued for dwelling construction, a review of the GHC's Loan Loss Reserve and provide observations on its adequacy based on findings and in relation to the GHC's policy, a review underwriting procedures, and provide observations on its soundness and a review of collateral values and all REO properties and properties that are referred to legal for foreclosure. This review should be completed by mid-August.

As a follow-on to the focus on servicing loans and a review of the portfolio, it is anticipated that enhanced internal procedures will be institutionalized.

00-5 Criteria:

Statement on Financial Accounting Standards No. 5, *Accounting for Contingencies*, (SFAS No. 5) and Statement on Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan* (SFAS No. 114), as amended, are the primary sources of guidance on accounting for the allowance for loan losses.

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. Allowances for impaired loans are generally determined based on collateral values or the present value of estimated cash flows. 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 loan loss. Moreover, the Corporation has not performed a detailed review or assessment of collateral value of its loan portfolio particularly its non-performing loans to determine its credit risk should such loans result in foreclosure. At September 30, 2000, we adjusted the Corporation's allowance for loan losses to $1,110,805, which was adjusted up from $110,805 during the 1999 financial audit. Based on our review of the loan portfolio, this amount may not be sufficient for potential credit risk as of September 30, 2000.

Cause:

The Corporation has not established written policies and procedures for determining the allowance for loan losses based on generally accepted industry requirements.

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, 2000

00-5 Recommendation:

We recommend that the Corporation 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 No. 114. Allowance for loan losses 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, credit concentration, 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 the Corporation's audit for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

The Loan Loss Allowance needs to be amended, but needs to be adjusted in relation to finalizing several on-going reviews of the GHC, including aggressive delinquency performance actions and the portfolio review.

Loan loss allowances have been addressed after previous audits. However, no adjustments were made, as losses have not been recorded because REO has not been liquidated. Moreover, until recently Guam enjoyed a period of rising property values together with GHC's low loan balances. Based on the current environment these allowances may be adjusted and a new policy incorporated.

It may be appropriate to reconsider the extent to which this allowance was elevated as it may have been based on the slow performance of some of the loans. Since this report we have been able re-energize many of these accounts while increasing their respective performance.

00-5 Auditee Response/Corrective Action Plan:

The review of the GHC's loan portfolio now underway is to address "the general condition of the loan portfolio and the adequacy of the GHC's Loan Loss Reserve." This review, together with delinquency performance actions of the loan division, will serve as a basis to establish the appropriate loan loss allowance. Additionally, the collateral value on non-performing assets is being assessed in this review.

00-6 Criteria:

The Lada Estates Affordable Subdivision Improvement 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 units are to 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. The project called for the subdivision to consist of 399 house lots.

Condition:

The Lada Estates Affordable Subdivision Improvement Project has been on going for over ten years and has accumulated land development costs approximating $13,173,000 as of September 30, 2000.

Phase 1 of the project has been completed; however, the Corporation has not been able to obtain a contractor to complete Phase 2 of the development project. The Phase 2 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 Phase1 of the project. Ultimately, this cost will be borne by the homebuyer on Phase 2 of the project. Subsequent to September 30, 2000, management represented that a successful bidder was selected and negotiations were on going. The Corporation had projected that individual housing units would be sold ranging between $110,000 to $140,000; however, 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, it appears that either the all of the housing units will not be sold or will be sold at a loss. No loss provision has been established to recognize this potential loss.

00-6 Condition: (continued)

The Corporation has a contractual liability payable to Maeda Pacific Corporation totaling $10,555,000 for the cost associated with the Lada Estates Affordable Subdivision Improvement Project Phase 1. Of this amount, $2.9 million is due from the Government of Guam for its share of the costs associated with off-site infrastructure access roads. Maeda Pacific Corporation is seeking payment plus an additional $1,803,0000 as interest charges for non-payment of the contract amount that is being disputed by the Corporation.

The contract states that the Corporation will pay the contractor within ninety (90) calendar days upon completion and acceptance of all work. The contractor's work was substantially complete on July 24, 1998. The Corporation certified the funds available to fund this phase of the project; however, payment has not been made. Conversely, Section 12 of Part B to Addendum 4 of the Re-Bid Package states that the successful bidder of Phase 2 will be obligated to pay for the cost of Phase 1.

Cause:

The Corporation was not able to obtain sufficient qualified buyers for the Lada Estates project and was not able to successfully bid out and obtain a qualified contractor for the completion of Phase 2 of the project in a timely manner.

Effect:

The Corporation does not have the funds to pay the amounts due to the contractor. This condition also contributed to the issuance of a going-concern opinion on 2000 audited financial statements.

Recommendation:

Management should conduct a thorough review of the land development cost incurred to-date along with projecting the construction cost and selling price of the Lada Estates housing units to ascertain the projected loss on the sale of such units. Afterwards, the Corporation should consider establishing a reserve for the loss on the sale of such units.

We recommend that the Corporation seek legal counsel advise to determine who is ultimately responsible for payment of the $10.5 million payable to Maeda Pacific Corporation and seek advise on the disputed $1.8 million in interest claimed by the contractor.

00-6 Auditee Response/Corrective Action Plan:

The Lada Estates project has been complicated by the general decline in economic conditions in the island and the stepped-phase development that has not moved beyond Phase I. A proposed developer for Phase II of the Lada project is currently in negotiation with the GHC and the Phase I developer. If Phase II proceeds in accordance with the conditions of the Request for Proposals for Phase II, Phase I development costs will be assumed by the Phase II developer and some of the GHC's project development costs will be recovered as development of Phase II proceeds.

In accordance with the contract between the GHC and the Phase I developer the GHC is not liable for payment on Phase I developments until the commencement of Phase II. Additionally, it is significant to note that the GHC is holding receivables that may be reduced relative to the passage of PL 25-116, that establishes the Government of Guam's responsibility for the off-site infrastructure costs ($2.915 million) in the Phase I development; lowering GHC-attributable Phase I costs to be paid at the commencement of Phase II to $7.6 million (plus $80,000 on subdivision plans and amendments (with no interest calculated)).

00-7 Criteria:

Advance payments by borrowers for taxes and insurance should be maintained in an escrow account at sufficient levels to cover such payments as they become due in the ordinary course of business.

Condition:

Based on our review of the Corporation's reconciliation of the escrow/trust fund balances on the loans receivable trial balance, we noted 116 or 15% of the Corporation's loan portfolio had debit balances totaling $118,366 representing amounts due from borrowers. The individual amounts from borrowers ranged from $100 to $6,145 with an average amount of $1,020 due from such borrowers. Based on our inspection of the loan files, no documentation was on-file to evidence that repayments arrangement were in effect or any other correspondence to indicate that the respective borrowers were properly notified to cure amounts in arrears.

00-7 Cause:

There appears to be a lack of established 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 taxes and insurance payments which is negatively impacting the its operations and cash flow position.

Recommendation:

We recommend that the Corporation establish and implement 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. Additionally, each borrower should be contacted and arrange to cure the amount in arrears as soon as possible or at some agreed-upon specified date. Monthly reports should be prepared and submitted to loan administrator and loan servicing personnel to follow up with borrowers for any deficiency in their trust fund account.

Auditee Response/Corrective Action Plan:

As a part of the internal operational enhancements that are on-going as a part of the recovery and reorganization process, additional assistance is being internally provided to the Trust Fund Clerk to validate records and cure accounts.

00-8 Criteria:

All loans applications should be properly documented and verified to evidence qualification prior to approval and disbursement of loan proceeds.

Condition:

During our review of the employee loan files, for Loan #59802413 whose loan amount was $125,000, we noted that the loan application indicated a co-borrower when the application was submitted and subsequently approved. However, based on review of the promissory note, title insurance, mortgage deed, the co-borrower's name was not indicated. No other documentation was on file to evidence or indicate that employee was qualified for the loan.

00-8 Cause:

The cause of this condition is unknown.

Effect:

The effect of the above condition is that the above loan may not have been properly reviewed and approved.

Recommendation:

We recommend that management investigate this loan to determine whether the borrower was qualified for the loan without the co-borrower and was properly approved.

Auditee Response/Corrective Action Plan:

This loan has been examined and might more properly be identified as a file with room for improvement relative to documentation. The borrower qualified on their own merit and the co-borrower should have been deleted from the application and that probably would have solved the issue. From the recollection of division heads at GHC, it was the applicant's intent to include the co-borrower on title but not the mortgage.

The file shows that the “co-borrower” had neither income nor an interest in the property, although no finding in the files documents the “co-borrowers” failure to add anything of value to the applicant. However, the file has been reviewed and validates the information noted here.

Auditor’s Response:

The loan file was re-examined and the borrower was determined eligible for Corporation’s loan program participation. All loan application was subsequently amended to delete to the original co-borrower.

We recommend that the Loan Administrator and Compliance officer exercise care and due diligence in reviewing all loan documentation to ensure that such information is consistent throughout the loan review and approval process. Any communications with the borrower to include third parties as co-borrowers should be properly documented and verified throughout the process.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-9 Criteria:

The Corporation should maintain an updated database on all borrowers.

Condition:

Based on our audit of loan balances, we noted that twenty-four (24) 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 three 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 cause of this condition is unknown.

Effect:

There is no direct material effect on the financial statements as a result of this condition. However, this does 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, 2000

00-9 Prior Year Status:

The lack formal written internal control policies and procedures to evaluate loans for potential loan loss was reported as finding in the Corporation's audit for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

Keeping the borrower database current remains an on-going effort. This effort has been intensified as a result of the provision of information to creditors on loans that have been provided as collateral, loans made from notes provided by creditors and on in-house uncommitted loans.

A database on customers is also available through the GHC's Mortgage Servicer (MS) software. The current level of use of the software by GHC staff is of a proficiency and timeliness (on monthly data input) that the auditors did not observe during the audit period. Moreover, issues of concern that have been identified by staff and the auditors (e.g. time sensitive information for trust, and insurance postings) are in the process of being addressed holistically.

00-10 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 to be filed in accordance with the index on the checklist and in certain files; documents were loosely kept in the loan files. In 16 of 60 or 27% of 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.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-10 Effect:

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

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 done. 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, 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 year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

Loan file maintenance relative to orderliness is associated with the underwriting criteria at the time the loan is written or management style. Notwithstanding stylistic approaches to file management, in the process of reviewing files and preparing information on each loan for creditors, to the extent possible, files have been individually and collectively reordered and indexed for easier access and ease of information retrieval.

These files are visited annually with the installation of tax and hazard insurance statements and are updated at this time.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-11 Criteria:

In accordance with Corporation's promissory note provisions, the borrower shall pay to the note holder a late charge of 5% of any monthly installment not received within fifteen (15) days after the installment due date.

Condition:

For 10 of 25 or 40% of cash receipts from loan payments tested, we noted that a late fee of only $5 rather than 5% was being charged to the borrower. This occurrence appears pervasive and we attempted to project the cumulative potential loss in late charge revenues.

Total payments due	$ 5,985.55
Late fee charge	5%
Actual late fee	299.28
Late fee charged on 10 loans	(50.00)
Late fee under-charged	$ 249.28

The potential loss of revenues on the 10 loans is based on the average of $24.93 under-charge per loan and extrapolated on a total of 749 loans outstanding as follows:

Total number of loans	749
Known % of late loans	x 40%
Projected number of late loans	300
Average late fee per loan	x 33.38
Projected late fee loss per month (rounded)	$ 10,014.00
Annualized projected loss (rounded)	$120,168.00

Cause:

The Corporation did not strictly adhere to the conditions specified in the promissory note.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-11 Effect:

The Corporation has improperly applied late fee charges and had a potential loss of late fee revenues totaling $120,168.

Recommendation:

We recommend that GHC reconsider charging the 5% late fee. While the Corporation has implemented a policy of charging borrowers 5% for late payment, such is limited to a maximum of $50. This limitation still negatively impacts the Corporation, as numerous borrowers' late payments exceed $50 and thus means that the Corporation is financing non-performing loans. Consequently, we recommend that the Corporation charge a 5% fee on all delinquent and late payments and discontinue the $50 limitation. This will not only increase the amount of revenues GHC derives, but encourage borrowers to pay in a timely manner.

Prior Year Status:

The loan payment late fee $5 rather than 5% charged to the borrower and potential loss of revenue was reported as finding in the Corporation's audit for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

The Board of Directors set the charges assessed for late fees. Whether the account was assessed the $ 5.00, the 5% or the $50 is determined by the date in which the account was due (if prior to the policy change), not when the payment was made.

00-12 Criteria:

Loan file documentation should be maintained in a chronological and systematic manner.

Condition:

Over half of the loan files examined contained loose documents within the file or were not filed in a systematic or chronological order. Consequently, we spent considerable time locating loan documents to complete our examination of loan compliance procedures.

00-12 Cause:

The cause of this condition is unknown.

Effect:

There is no effect on the financial statements as a result of this condition.

Recommendation:

The documentation of a given loan file varies depending on the type of loan, the collateral, the borrower and other factors. The contents of a typical loan file should be organized by section and maintained in chronological and systematic order.

Prior Year Status:

The lack of adequate loan file maintenance was reported as finding in the Corporation's audit for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

Loan file maintenance relative to orderliness is associated with the underwriting criteria at the time the loan is written or management style. Notwithstanding stylistic approaches to file management, in the process of reviewing files and preparing information on each loan for creditors, to the extent possible, files have been individually and collectively reordered and indexed for easier access and ease of information retrieval.

These files are visited annually with the installation of tax and hazard insurance statements and are updated at this time.

00-13 Criteria:

The Corporation requires a Mortgage Loan Underwriter to properly complete loan packages before submission to the Loan Administrator for approval.

Condition:

The Corporation does not have a Mortgage Loan Underwriter. The Loan Administrator is conducting the duties of a loan underwriter in addition to assigned duties. Consequently, there is no segregation of functions relating loan administration and underwriting.

Cause:

The cause of this condition is unknown.

Effect:

Proper screening of applicants and determination of eligibility could be compromised due to a lack segregation of duties stemming from the vacant position.

Recommendation:

We recommend that management proceed with filling the vacant Mortgage Loan Underwriter position as soon as possible to ensure that there is a quality control function to monitor documentation and underwriting practices and that loan underwriting and approval duties are properly segregated.

Prior Year Status:

The filing of the vacant Mortgage Loan Underwriter position was reported as finding in the Corporation's audit for the fiscal year ending September 30, 1999.

Auditee Response/Corrective Action Plan:

In light of the on-going restructuring activities, the GHC management does not believe that there is a necessity of filling the position of Loan Underwriter.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2000

00-14 Criteria:

Typhoon insurance coverage is required to be maintained on single-family residential homes as a condition of the loan agreement. Typhoon coverage may be excluded when the dwelling unit is equipped with professional typhoon shutters.

Condition:

Based on our review of loan files, we noted that the insurance policy typhoon coverage rider was deleted; however, there was no documentation on file to evidence that borrowers had installed typhoon shutters, as follows:

Loan Numbers

19702359	59002025	59302221	59302223	10002662
59702366	59702367	59802413	59802423	859002011
59802432	59802433	58902515	10002644	859402281

Cause:

The Corporation appears to rely on the insurance company to inspect and verify that the house is properly equipped with typhoon shutters.

Effect:

There is no financial effect on the financial statements as a result of this condition. However, there is a potential collateral risk should the above dwelling units are damaged as a result of a typhoon.

Recommendation:

We recommend that the Corporation contact the applicable insurance companies and verify whether the above borrowers have installed typhoon shutters to exclude insurance coverage and document such in the respective borrowers' files.

Auditee Response/Corrective Action Plan:

A visual inspection of residences of the 15 loan numbers cited is being conducted by the loan department to ascertain whether shutters are in place as is indicated by the insurance policy premiums.