

GUAM HOUSING CORPORATION
(A Component Unit of the Government of Guam)

REPORT ON COMPLIANCE AND INTERNAL CONTROL

FOR THE YEAR ENDED SEPTEMBER 30, 2008

J. Scott Magliari
COMPANY

CERTIFIED PUBLIC ACCOUNTANT

GUAM
P.O. BOX 12734 • TAMUNING, GUAM 96931
TEL: (671) 472-2680 • FAX: (671) 472-2686

SAIPAN
PMB 297 PPP BOX 10000 • SAIPAN, MP 96950
TEL: (670) 233-1837 • FAX: (670) 233-8214

**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:

I have audited the financial statements of Guam Housing Corporation (a public corporation), as of and for the year ended September 30, 2008 and have issued my report thereon dated February 16, 2009. I conducted my 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.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Guam Housing Corporation's internal control over financial reporting as a basis for designing my auditing procedures for the procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the Corporation's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely manner. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Corporation's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Corporation's financial statements that is more than inconsequential will not be prevented or detected by the Corporation's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Corporation's internal control.

My consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily disclose all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are considered to be material weaknesses. I did not identify any deficiencies in internal control over financial reporting that I consider to be material weaknesses, as described above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Corporation's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, which are described in the accompanying Schedule of Internal Control Findings as items 08-01 through 8-04.

I noted certain matters that were reported to management of the Corporation in a separate letter dated February 16, 2009.

This report is intended solely for the information and use of the Board of Directors and management of the Guam Housing Corporation, the Office of the Public Auditor and the federal awarding agencies and pass-through entities and is not intended and should not be used by anyone other than these specified parties.


Hagåtña, Guam
February 16, 2009

GUAM HOUSING CORPORATION
(A Component Unit of the Government of Guam)

SCHEDULE OF INTERNAL CONTROL FINDINGS

FOR THE YEAR ENDED SEPTEMBER 30, 2008

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

PART I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

I have audited the basic financial statements of Guam Housing Corporation and issued an unqualified opinion.

Internal control over financial reporting:

- Material weaknesses were identified? _____yes x no

- Significant deficiency(ies) identified that are not considered to be material weaknesses? _____yes x None reported

- Noncompliance material to financial statements noted? _____yes x no

Federal Awards

The Guam Housing Corporation did not receive or expend any federal awards for the fiscal year ending September 30, 2008. Therefore, the Corporation it did not have any major federal programs.

PART II – FINDINGS – FINANCIAL STATEMENTS

I noted certain instances of noncompliance be reported in accordance with *Government Auditing Standards* that are presented in the following pages as items 08-01 through 08-04.

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Costs</u>
08-01	Loans Receivable – First-time Homeowners	\$ -
08-02	Loans Receivable – Delinquency and Loan Servicing	-
08-03	Loans Receivable – Insurance Coverage	-
08-04	Loans Receivable – Title Reports	-
		<u>\$ -</u>

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 01

Area : First Time Homeowner

Criteria:

Pursuant to the Corporation's loan policy, first time homeowners are defined as those individuals who have not had any type of ownership interest in a single family resident unit or a residential 1-4 family unit within the preceding five (5) year period, from the date of application with the Corporation. First time homeowners shall also include those individuals who have an ownership interest in a single family residential unit or a residential 1-4 family unit within the preceding five (5) year period, from the date of application with the Corporation, if that interest was terminated by decree of divorce or an operation of law.

Condition:

During our testing of the eighteen (18) new loans approved during fiscal year 2008, for home construction loan #50802772 for \$170,000 dated December 6, 2007, which was applied for by wife (sole borrower) of a married couple we noted the following:

1. The total household income exceeded GHC's allow income limits and requirements; however, the loan was applied by wife using only her income.
2. The borrower's spouse owns an apartment unit acquired prior to marriage to the borrower.
3. Based on review of the title report, the land used for the construction of the home, is jointly owned.
4. The construction home loan was reviewed by but not recommended for approval by the Loan Committee but instead was submitted to the Board of Directors for approval.
5. The borrower's husband executed a "Consent to Mortgage" or waiver of any claim of legal interest to the property that was used as collateral for the construction.
6. The mortgage was executed and signed by both husband and wife; however, management represented that certain Title companies require both husband and wife must join in executing a mortgage.

Based on the above facts, this loan may not have met the Corporation's criteria for First-time Home buyers.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 01, continued **Area : First Time Homeowner**

Conditon: (continued)

Subsequent to September 30, 2008 and to the loan approval, management obtained a legal opinion which stated that based on the facts provided to legal counsel, the Corporation's loan policies and enabling legislation 12 GCA§4, et.seq, are silent in situations where only a spouse applies for a loan with the other spouse agreeing to waive any claim of interest in the property collateralized and the waiving spouse also owns or maintains an interest in other real property from a prior relationship. Consequently, since the law and the Corporation's policies are silent regarding this type of situation, discretion lies solely with the Corporation to approve this type of loan.

Cause:

The Corporation's loan policies and enabling legislation 12 GCA§4, et.seq, do not specifically address or provide requirements for situations where only a spouse applies for a loan with the other spouse consent to waive any claim of interest in the property collateralized and the consenting spouse also owns or maintains an interest in other real property.

Effect:

The Corporation may have approved a loan may be in noncompliance with its loan policies and enabling legislation 12 GCA§4, et.seq.

Recommendation:

The Corporation's management and Board of Directors should review and modify existing loan policies to establish certain criteria defining what constitutes First time Home Buyers for married parties and for those parties who co-habitate particularly where only one spouse applies for a loan while married or co-habiting and for situations whereby one party owns or has a legal interest in existing property. Consideration should also be given to determining household income of the spouse applying for the loan and whether or not both husband and wife or co-habitors should be used such calculation.

Auditee Response and Corrective Action: Plan:

GHC Management in consulting legal counsel has determined that the loan in question was within the parameters of the law in regard to first time homebuyers. Legal counsel has recommended that GHC take measures to strengthen loan policy to address any gray areas in public statute that may allow for broad interpretation. It may be noted that the laws setting the parameters in which the corporation operates may be dated and in need of revision.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 02

Area : Loans Receivable/Delinquency and Loan Servicing

Criteria:

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

No later than three (3) business days after a loan has reached 90 days past due and placed on non-accrual status, the Loan Department must prepare and submit to the Loan Administrator a request for legal assistance. Within two (2) days of receipt, the Loan Administrator must review and forward the request to the President for approval. Within two (2) days of receipt, the President must review and return the request with final approval or disapproval. In the event the request is approved for legal action, the Loan Administrator must prepare and deliver a request for foreclosure package to the Corporation's legal counsel. In the event the President does not approve the request for legal assistance, he or she must demonstrate and document why the delinquent account should not be referred to legal counsel.

Condition:

We conducted a review of the payment history of borrowers subsequent to September 30, 2008 to evaluate potential non-performing and delinquent loans. Based on our review of the loan portfolio we noted delinquent loans that were outstanding in excess of 90 days that were pledged as collateral with the Federal Home Loan Bank of Seattle, as follows:

<u>Item #</u>	<u>Loan No.</u>	<u>Unpaid Principal Balance as of 9/30/08</u>	<u>Number of Days Past Due</u>
1	19702351	\$ 64,522.57	194
2	19802548	143,557.47	1128
3	38501505	15,992.84	91
4	59302262	94,840.55	315
5	59302227	45,902.98	262
6	59802430	146,935.88	651
		<u>\$511,752.29</u>	

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings Year Ended September 30, 2008

Finding No. 08 – 02, continued

Area : Loans Receivable/Delinquency and Loan Servicing

Cause:

It appears that established written internal control lending policies and procedures should be strengthened and strictly enforced for identifying and servicing delinquent loans in a timely manner.

Effect:

The Corporation could incur material loan losses and increased foreclosures in future periods. Interest income was not recognized as a result of these non-performing delinquent loans.

Prior Year Status:

The lack of adherence to internal controls over delinquent loan servicing was reported in the 2007 and 2006 audits of the Corporation.

Recommendation:

The above loans should be evaluated for collectibility on a monthly basis and be carefully monitored. We recommend that the Corporation continue to reevaluate its existing collection and loan servicing policies and procedures to determine areas of improvement and staff assigned to perform such functions.

We commend management's aggressive review of its loan portfolio to service delinquent loans. This review and level of effort should be continued and consistently performed on a monthly basis. However, the Corporation should continue evaluating loans once the monthly scheduled payments are not remitted past the 15-day grace period. This will facilitate the process of identifying potential delinquent or troubled loans before they reach the 90-day non-performing status. This will enable the Corporation to have sufficient time to bring the loan current or establish a repayment or work-out plan with the borrower and ensure the collection of interest income and repayment of principal on the loan.

Auditee Response and Corrective Action: Plan:

1. 19702351 – This account was referred to legal counsel on 12/31/08 for collection action.
2. 19803548 – This account is with our legal counsel. Foreclosure procedures are pending PTR corrections.
3. 38501505 – The borrowers are deceased and we are working with the daughter, who resided off - island. The account is now 35 days past due.
4. 59302262 – A payment plan was implemented via payroll deduction amount \$650 each pay period.
5. 59302227 – The borrower has brought the account current and is now due on January 12, 2009.
6. 59802430 – This account will be forwarded to our legal counsel once a Conflicts Counsel has been awarded.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 03

Area: Loans Receivable/Insurance Coverage

Criteria:

Hazard insurance coverage must be maintained for all real estate property used as collateral for a loan. The coverage must provide protection against catastrophic loss resulting from damage or destruction to the collateral due to the perils of fire, earthquake, and typhoon. All housing hazard insurance policies must name Guam Housing Corporation as co-insured along with the borrower/owner of the property.

Typhoon coverage must be maintained on all structures in an amount equal to the principal amount of the loan. In no case is the amount of insurance coverage to be less than the principal loan balance. The replacement value of improvements must be determined by a licensed real estate appraisal. The Corporation will accept a hazard insurance clause of no less than 80% on a case-by-case basis, subject to approval by the President. Typhoon coverage may be waived based on a written request from the borrower, subject to the conditions as set forth in the Corporation's underwriting policies. All waivers of typhoon insurance coverage shall be recommended by the Loan Administrator and President and approved by the Board of Directors. Waivers shall be reviewed on an annual basis.

Condition:

For 7 of 55 or 13% of the loans tested, the following loans did not have adequate typhoon insurance coverage or a waiver on-file:

- | | |
|--------------|--------------|
| 1. #59202164 | 5. #19082546 |
| 2. #19802548 | 6. #18401426 |
| 3. #59302227 | 7. #38501561 |
| 4. #59802514 | |

Cause:

Timely inspections were not performed to evaluate each borrower's respective hazard insurance coverage annually.

Effect:

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

Prior Year Status:

Loans lacking adequate insurance coverage was reported as a finding in the audit of the Corporation for fiscal years 2005 through 2007.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 03, continued

Area: Loans Receivable/Insurance Coverage

Recommendation:

The Corporation should ensure that compliance to its underwriting hazard insurance coverage policy is properly implemented in a timely manner. Loans should be reviewed for adequate typhoon coverage upon insurance policy renewal.

Auditee Response and Corrective Action: Plan:

For loan number 19802548, the insurance company will not insure home as the house is not being occupied. This loan was referred to Legal Counsel for further action. For the remaining loans, letters have been sent requesting for certification of no claims and their request for waiver. GHC has conducted inspections and have verified that the dwellings are equipped with typhoon shutters. Our files also show no claims for typhoon damages within the past five years. Upon receipt of the requested info, GHC will approve their request for typhoon waiver. If borrowers do not submit info, GHC will request for the insurance to include typhoon coverage immediately. Borrowers were advised that their monthly payment will increase accordingly.

Finding No. 08 – 04

Area: Loan Receivable – Title Reports

Criteria:

A preliminary title report (PTR) serves as a basis for the commitment by a title insurance company to provide title insurance on a property's title. It shows the condition of a property's title at a specific time, indicating the current owner and any liens on the property that have not been removed. The Corporation's loan officer is responsible for reviewing all PTR's to include all stated exceptions that may impair the Corporation's mortgage position prior to loan origination.

Condition:

We read the title insurance policy, attorney's opinion letter or other title documentation and verified the collateral constitutes a first lien against the property and noted the following:

1. Loan #18401426 – Real property taxes were not paid for 1986.
2. Loan #59102120 – Real property taxes were not paid for 1990.
3. Loan #59802514 – Real property taxes were not paid for 1987 through 1990 and 1999.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 04, continued

Area: Loan Receivable – Title Reports

Condition: (continued)

In addition we examined loan files to determine that the collateral is wholly owned by the Corporation and that no participating or retaining interest is held by any other party and noted the following:

1. Loan #59302262: Property is collateralized with the Bank of Guam.
2. Loan #59202214: Property is collateralized with First Hawaiian Bank under loan #35-001031.
3. Loan #19802506: Property is collateralized with the Government of Guam Employees Credit Union.

Cause:

Loan files were not properly updated in a timely manner to ensure that all loan files are reviewed for proper documentation.

Effect:

The potential exists for loans to be improperly approved and for documents to be lost or misplaced. Additionally, as property taxes are basic source of funds to pay various public services within the Territory of Guam, ensuring settlement and clearing by the applicant should take first priority.

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, 2006 and 2007.

Recommendation:

Loan files should be periodically reviewed to ensure that all required documents have been obtained. The current loan documentation checklist should be compared to the actual loan documentation for verification during the loan origination process and prior to loan closing.

GUAM HOUSING CORPORATION

Schedule of Internal Control Findings
Year Ended September 30, 2008

Finding No. 08 – 04, continued

Area: Loan Receivable – Title Reports

Auditee Response and Corrective Action: Plan:

GHC has made a written request for certification of payment to the Department of Revenue and Taxation to document that the above taxes were paid. We await their response to our request.

For the above collateralized loans listed above, the noted mortgages are second mortgages obtained by borrowers. These mortgages do not jeopardize GHC's 1st lien position.