

**Department of Administration
Fund Transfers Pursuant to P.L. 28-151**

Limited Review

**OPA Report No. 07-09
August 2007**



OFFICE OF THE PUBLIC AUDITOR

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OFFICE OF THE PUBLIC AUDITOR

August 09, 2007

Honorable Alicia Limtiaco
Attorney General
Office of the Attorney General
287 West O'Brien Drive
Hagatna, GU 96910

Dear Attorney General Limtiaco:

On June 8, 2007, we met with you and your staff to discuss your request for the Office of the Public Auditor (OPA) to perform a limited review of monies transferred from certain funds to the General Fund pursuant to Public Law 28-151. On October 31, 2006, P.L. 28-151 authorized the Governor of Guam to expend funds from certain accounts listed in Attachment "A"¹ to pay Cost of Living Allowance (COLA) to eligible retirees.²

Transfer of \$9 million to pay FY 2007 COLA

Based on our review of the Department of Administration's (DOA) records and other pertinent documentation, we determined that during the first week of November 2006³, \$9 million was transferred to the General Fund from the following funds: \$4 million from the Tourist Attraction Fund (TAF) Construction Fund; \$4 million from the Territorial Highway Fund (THF) Construction Fund, and \$1 million from the Guam Telephone Authority (GTA) Privatization Fund. On November 1, 2006, 6,951 checks, totaling \$7,620,250⁴, were issued to pay retirees for fiscal year 2007 annual lump-sum COLA pursuant to P.L. 28-150, and not the court ordered COLA stipulated in P.L. 28-151.

Of the \$9,000,000 transferred from the above funds into the General Fund, the remaining \$1,379,750 appeared to be used to pay for operational expenses of the General Fund, such as payroll and vendor payments. However, we could not determine the specific payments made.

¹ Accounts listed in Attachment "A" were (1) GTA Privatization Fund; (2) Interim Transition Office Account; (3) THF Construction Fund; and (4) TAF Construction Fund.

² *Rios v. Camacho, et al.*, Superior Court Case No. SP0206-93.

³ The monies from the different funds were transferred to the General Fund on different dates during the first week of November 2006.

⁴ Pursuant to P.L. 28-150, retirees were entitled to COLA of \$1,100. However, the amount of some COLA checks varied based on the appropriate percentage to which survivors were entitled.

Chronology of Events

On October 28, 2006, the Guam Economic Development and Commerce Authority (GEDCA) inquired of bond counsel whether bond construction funds can be used to make COLA payments and if there were any tax implications/penalties associated with the proposed action.

In an e-mail dated October 30, 2006, bond counsel responded:

Under Section 3.03 of the related indenture, the proceeds of the Government of Guam Limited Obligation Highway Bonds, 2001 Series A [Territorial Highway Fund], deposited in the Construction Fund may only be used for Capital Improvement Highway Projects, as that term is defined in the indenture, unless such amounts are no longer required for purposes of said fund. The Depositary holds such amounts in trust and should decline any request for distribution or expenditure of such amounts that is inconsistent with the requirements of the indenture, even if the distribution or expenditure is in the form of a temporary “borrowing” of the proceeds... Bottom line-the use of Highway Bond proceeds to pay for COLA amounts to the retirement fund is not permitted if there are still highway projects to be completed...

Under Section 3.03 of the related indenture, the proceeds of the Government of Guam Limited Obligation Infrastructure Improvement Bonds, [2001] Series A [Tourist Attraction Fund], deposited in the Construction Fund may only be used for Infrastructure Improvement Projects, as that term is defined in the indenture, unless such amounts are no longer required for the purposes of said fund.

However, bond counsel cautioned:

There was, of course, no disclosure made to investors that bond proceeds could be used to make a COLA payment to the retirement fund, and there may be some feeling among investors that the improvement of the infrastructure of tourism areas is closely enough linked to the revenues securing the bonds (hotel taxes) that the limitation of the bond proceeds to tourism infrastructure projects would be important... It is not possible to make the judgments needed to make a recommendation concerning whether the use of the proceeds of the [2001] Infrastructure Improvement Bonds is appropriate under the circumstances. That judgment can only be made with full knowledge of the other sources available for the COLA payment, the consequences of delaying the COLA payments, the likelihood of reimbursement, the importance of the infrastructure projects currently under way that would be stopped or that are not yet underway but planned, etc.

On October 31, 2006, two government certifications signed by the Governor, the Director of the Department of Public Works (DPW), and the Director of DOA, were issued to the bond trustees certifying that \$4 million from the TAF Construction Fund and \$4 million from the THF Construction Fund were no longer required for the purpose of the said Funds in accordance with their Indentures.

The bank trustee for the Territorial Highway Fund also raised a concern with the use of bond proceeds for purposes other than the indenture. An e-mail dated October 31, 2006 from the bank trustee to the bond counsel stated:

Under Section 5.02, funds in the Revenue Fund cascade into the Bond Fund (interest, principal & mandatory sinking fund), then the Bond Reserve Fund, then the Maintenance and Operation Fund, then the Surplus Fund . . . It is the last phrase that has left me wondering whether I can disburse these funds for the purpose stated; the COLA is obviously not associated with building or maintaining roadways, and I wonder whether this is a permissible use of the funds.

Also on October 31, 2006, a letter from the Interim Transition Coordinating Committee Executive Secretary to the Department of Administration authorized the Treasurer of Guam to transfer \$1,000,000 from the GTA Privatization Fund into the General Fund.

In a November 1, 2006 e-mail to the bank trustee, the bond counsel responded:

Once the Government has certified that moneys in the Highway Bond Construction Fund are no longer required for the purposes of the Construction Fund, the moneys are to be paid to the Government on the fifth of the month and may be used by the Government for any Government purpose. At that point, the moneys are not restricted by the indenture to highway purposes.

In a February 21, 2007 e-mail to GEDCA, the bond counsel further responded:

Ultimately, assuming that the Government is in a deficit position as defined by the tax rules (which I believe to be the case)... the moneys in the two construction funds can be used to make COLA payments... The reimbursement of such funds when moneys are available for that purpose is not required, but as noted below, may be advisable from a market perspective.

On May 17, 2007, the DPW Director wrote a letter to the DOA Director requesting that \$4,000,000 be restored back to the THF in light of P.L. 28-151 as the funds are needed to complete Phase I of the Islandwide Village Street Restoration and Pothole Projects in accordance with P.L. 28-68.

In a July 25, 2007 e-mail, the DOA Director noted that the General Fund will not reimburse the \$4,000,000 to THF. The General Fund will instead absorb any additional costs to DPW's on-going projects.

Tax Implications

In an October 30, 2006 e-mail, bond counsel stated:

The Infrastructure Improvement Bonds were originally issue[d] for capital projects and qualified for their tax exemption under those rules. The proposed use is to fund an operating expense that will take place on a current basis, which would result in the bonds being treated as "working capital" bonds, subject to the need for a demonstrated general fund deficit, documented with a supplemental tax certificate. If, as and when the deficit financing bonds are issued and a portion of their proceeds used to reimburse the Infrastructure Improvement Bond Construction Fund, the deficit financing would, to that extent, be treated as a capital project financing (rather than a working capital financing).

On November 27, 2006, GEDCA Acting Administrator wrote a letter to the Governor's Chief of Staff expressing concerns to comply with bond counsel's request to document the tax treatment associated with the execution of a Certificate of Government. The DPW Director did not provide GEDCA: (1) a list of projects funded by the TAF and THF construction funds that are no longer on-going and (2) the funding source for any on-going projects that would have been funded by the said construction funds.

The Attorney General may want to explore the tax implications related to this matter.

Senseramente,



Doris Flores Brooks, CPA, CGFM
Public Auditor

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