



OFFICE OF THE PUBLIC AUDITOR

EXECUTIVE SUMMARY

Promissory Notes Program
Department of Administration, Government of Guam
Report No. 08-01, May 2008

In Fiscal Year (FY) 2006 the government of Guam reported a General Fund deficit of \$524 million. The substantial deficit resulted in a cash crisis that has affected line agency operations, leaving vendor contractual obligations unpaid. Through legislation, the government of Guam established a promissory note program¹ as a financial alternative for the lack of available cash, and as a means to manage its short-term obligations while the government awaits future tax receipts or credits to retire or redeem the notes.

Use of Promissory Notes

In FY 2007, the government of Guam issued 21 promissory notes totaling \$3.2 million. Over 70% of the notes issued, or 15 notes totaling \$1.9 million, were for the Guam Public School System (GPSS) for janitorial, photocopying, security, and air conditioning services. The remaining 30%, or six notes totaling \$1.3 million, were for the executive branch line agencies for fuel fleet services. As of January 2008, nearly \$2.2 million in gross receipts taxes (GRT) has been applied against the \$3.2 million promissory note liability, leaving approximately \$1 million in outstanding unredeemed balances, which can be sold by the note-holder to other parties or applied as a tax credit against taxes due to the government by the note-holder.

Of the 21 promissory notes issued in FY 2007, we found:

- *Vendors sold promissory notes for credits:* GPSS issued eight promissory notes totaling \$971,449 to one vendor, who sold five notes to 25 other local businesses.² The businesses in turn applied tax credits totaling \$564,381. The vendor utilized \$168,588 as GRT offsets leaving a balance of \$238,480 on outstanding notes yet to be redeemed. The company's chief executive officer informed us that promissory notes were sold for cash and several were sold at a discount in order for his company to obtain working capital.
- *GPSS promissory notes were issued without being verified or certified:* GPSS did not produce the required aged open invoice reports for nine promissory notes totaling \$1.1 million; and GPSS also did not certify the validity of the aging accounts owed to vendors before promissory notes were issued.

These conditions occurred because the law governing promissory notes did not establish controls over the sale and transfer of promissory notes, and the issuing agency did not regulate such activities.

¹ A promissory note is a type of negotiable instrument which details the terms of a promise by one party (the *maker*) to pay a sum of money to the other (the *payee*). The obligation may arise from the repayment of a loan or from another form of debt. The promissory note offers vendors who are unpaid for contracted services past 30 days a gross receipt tax credit bearing a 7% interest rate per annum with maturity date period of 365 days.

² The OPA was unable to determine the means of exchange between vendors.

DOA Director Finds Promissory Notes Beneficial

The DOA Director stated the promissory note program in FY 2007 was beneficial to vendors who were not paid timely for services provided because it offered payment in the form of “relief of gross receipts taxes due and payable.” The DOA Director contends that while the vendors received payments in the form of tax offsets, the major disadvantage of the program was in the reduction of cash receipts to pay for other government of Guam obligations.

Budget Act Adds Controls

Significant improvements to the requirements for administration of the promissory note program were made in the 2008 Budget Act.³ The Budget Act specifies that promissory notes issued after September 30, 2007, are non-transferable and cannot be applied against any tax obligation. The provision eliminates the ability of vendors to use the promissory notes as a tax credit and requires the Government of Guam to have funds available to pay the obligation. The law also places a maximum threshold amount on promissory notes. Notes issued after September 30, 2007, cannot exceed two percent of the General Fund’s expected revenue forecast. As of January 2008, DOA has yet to issue a 2008 promissory note. Both the DOA Director and the DRT Deputy Director agreed that the 2008 Budget Act improved the overall accounting and management of promissory notes.

We commend the Legislature for taking swift action to correct deficiencies in the legislation administering the promissory note program. However, we recommend that (1) the Legislature consider restricting the use of vendor promissory notes to agencies receiving General Fund appropriations, as the autonomous agencies should have the financial capabilities of paying their own debts, and (2) DOA and DRT provide quarterly and annual reports to the Legislature detailing the amount of promissory notes issued and the total amount of tax credits used as offsets for the remaining promissory note balances.



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³ P.L. 29-19, Chapter VIII, Section 7