



OFFICE OF THE PUBLIC AUDITOR

**Department of Administration
Health and Human Services Fund and
Youth Tobacco Education and Prevention Fund**

Performance Audit

**OPA Report No. 04-12
October 2004**

Distribution:

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President, Guam Community College

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Guam Media via E-Mail



MANAGEMENT LETTER

October 22, 2004

Ms. Lourdes Perez
Director
Department of Administration
P.O. Box 884
Hagåtña, Guam 96932

Mr. Gerald Perez
Director
Guam Economic Development and Commerce Authority
Suite 511 ITC Building
Tamuning, Guam 96913

Subject: Tobacco Settlement Asset-Backed Bond Funds

Dear Ms. Perez and Mr. Perez:

This letter represents the results of our audit of the Health and Human Services (HAHS) Fund and the Youth Tobacco and Education Prevention (YTEP) Fund, which was conducted in accordance with standards for performance audits as contained in *Generally Accepted Government Auditing Standards*, as issued by the U.S. Comptroller General. This audit was completed as part of our overall review of Special Revenue Funds administered by the Department of Administration (DOA). In conjunction with our audit of the HAHS and YTEP Funds, a limited review was also conducted of the Health and Security Trust (HST) Fund, the University of Guam (UOG) Higher Education Endowment Fund and the Guam Community College (GCC) Endowment Fund. Our audit objective was to determine whether the Funds were utilized and accounted for in accordance with their original intended purposes.

Background

In 1998, Guam became one of the beneficiaries of settlement amounts received as a result of a multi-billion dollar class action lawsuit against tobacco manufacturing companies. The Attorneys General of Guam, 46 states, the District of Columbia, and four U.S. territories filed lawsuits against four of the largest U.S. tobacco manufacturers. A Master Settlement Agreement (MSA) was reached in November 1998, and Guam along with its co-plaintiffs, were granted rights to receive certain portions of the settlement in the form of initial, annual, and strategic contribution fund payments subject to certain adjustments. These types of payments commence

and end at different times and at different amounts. Annual payments are a source of revenue for Guam and continue in perpetuity. The total litigation settlement in aggregate is more than \$360 billion.

In 2001, the Legislature through Public Law (P.L.) 25-187 and P.L. 26-04 authorized the Guam Economic Development and Commerce Authority (GEDCA) to securitize¹ a portion of the Government of Guam's interest in the tobacco settlement and issue bonds to create immediate capital. A portion of the proceeds from the tobacco litigation settlement was pledged to repay bondholders. P.L. 26-04 also irrevocably assigned the tobacco litigation settlement proceeds, beginning April 10, 2001, to the GEDCA.

The issuance of the bonds allowed the Government of Guam to access funds for immediate use. The two types of bonds issued were Series 2001 A bonds and Series 2001 B bonds. The Series 2001 A bonds sold for \$11,982,980 and the Series 2001 B bonds sold for \$13,494,479. The proceeds of the bonds, less debt-service reserves, costs of issuance, and other fees or discounts were \$21,479,954.

The \$21.5 million in bond proceeds were deposited into five separate Tobacco Settlement Asset-Backed Bond Funds to be spent for health care and higher education. Each Fund received a different percentage allocation from the net proceeds (see Attachment 1). The five Funds are as follows:

- **Health and Human Services (HAHS) Fund** – originally established in 1998 to finance health care and tobacco prevention educational programs under the Department of Public Health and Social Services (DPHSS). The DOA accounts for this Fund.
- **Youth Tobacco Education and Prevention (YTEP) Fund** – to develop youth compliance monitoring and tobacco and drug prevention and education programs by the Department of Mental Health and Substance Abuse (DMHSA). The DOA accounts for this Fund.
- **Health Security Trust (HST) Fund** – to finance the operations of the Guam Memorial Hospital Authority (GMHA). Although the law does not clearly define the administrator of the Fund, the DOA has assumed the responsibility to account for this Fund.
- **University of Guam (UOG) Higher Education Endowment Fund** – to fund the management and enhancement of learning resources and technology of the UOG. Although the law identifies the UOG as the administrator of this Fund, the DOA has assumed the responsibility to account for this Fund.
- **Guam Community College (GCC) Endowment Fund** – to fund the management and enhancement of learning resources and technology of the GCC. The GCC accounts for this Fund.

According to P.L. 25-187, later amended by P.L. 27-69, the beneficiaries are authorized to expend all proceeds received from the Series 2001 A bonds immediately upon appropriation by

¹ Securitization means to buy (loans) from lenders, arrange them in groups, and issue bonds on the groups. In this case, the Government of Guam will sell its future interests in the tobacco settlement for a sum of money that is immediately available for use.

the Legislature, the UOG Board of Regents, or the GCC Board of Trustees. After four years², any unexpended balances of Series 2001 A bonds must be converted to Series 2001 B bonds, which are subject to different mandates. Series 2001 B bond proceeds require at least 95 percent, if not all, of the Series 2001 B bond proceeds be reinvested in tax-exempt obligations (e.g. municipal bonds). All amounts not invested in tax-exempt obligations are subject to the Rebate Requirement.³ Approximately 90 percent of the earnings from this reinvestment can be expended for the various Fund purposes. Only the HAHS Fund is not subject to these requirements because of a legislative conflict with P.L. 26-03.

RESULTS OF AUDIT

The Government of Guam did not ensure that all the Tobacco Settlement Asset-Backed Bond Funds (Series A) were used in a timely manner. This condition occurred because of a lack of coordination between the administering departments⁴ and the Guam Legislature to appropriate monies to expend the Funds. The Legislature, through P.L. 27-69, decided to extend the expiration date to expend Series 2001 A bond proceeds to June 2005 due to the two typhoons that ravaged Guam in 2002. As of June 30, 2004, the Government of Guam did not utilize \$4.4 million⁵ of Series 2001 A bond proceeds in a timely manner. If \$3.4 million of the \$4.4 million is not utilized by June 2005, it will be transferred to the Series 2001 B balances. Thereafter, only interest from investments will be available for expenditure by the Government.

Health and Human Services (HAHS) Fund

In anticipation of the tobacco settlement proceeds assigned to Guam, the Legislature originally established the HAHS Fund⁶ to receive all settlement proceeds for use by the DPHSS. The Legislature subsequently reassigned future settlement proceeds to the GEDCA for the issuance of the tobacco settlement asset-backed bonds.⁷ The HAHS Fund no longer receives settlement proceeds but is assigned \$2,147,995⁸ or 10 percent of all proceeds received from the tobacco settlement asset-backed bonds. The HAHS Fund would also receive 20 percent of all fines and fees collected by the Department of Revenue and Taxation (DRT) of penalties assessed on tobacco control.⁹

As of 2003 fiscal year-end, the HAHS Fund had a fund balance of \$2,579,403 and liabilities of \$225,084, of which \$1,018,991 is from Series 2001 A bond proceeds, \$1,202,466 is from Series 2001 B bond proceeds, \$581,968 from tobacco settlement proceeds, and \$1,062 from interest

² P.L. 27-69 extended the bond conversion deadline from three to four years, expiring in June 2005. However, the law does not apply to the HAHS Fund because of a legislative conflict with P.L. 26-03.

³ The Rebate Requirement is a rebate liability to the federal government for failure to reinvest bond proceeds in tax-exempt obligations.

⁴ With exception of the UOG and GCC Boards, who were given authority to appropriate from their Funds by the Legislature.

⁵ Of the \$4.4 million, only the HAHS Fund, totaling \$1 million, does not expire June 2005.

⁶ P.L. 24-174.

⁷ P.L. 25-187 and P.L. 26-04.

⁸ Of the \$2.1 million, \$982,247 is from Series 2001 A bonds and \$1,165,748 is from Series 2001 B bonds.

⁹ DRT collections are deposited directly into the General Fund.

earned from a previously closed account. However, only \$1.6 million would be available if the bond restrictions were applied.

During our review, we found that the HAHS Fund has not incurred any expenditure from the time when it first received tobacco bond proceeds in 2001. The failure of the DPHSS to utilize the HAHS Fund defeats the Government's purpose of issuing bonds to obtain an immediate flow of capital. Therefore, we recommend the DPHSS work in conjunction with the GEDCA, the DOA, and the Legislature to initiate a plan to utilize the HAHS Fund to finance health care and tobacco prevention educational programs and/ or other related projects.

In March 2001, the Legislature subsequently passed P.L. 26-03 changing the nature of the HAHS Fund. The law did not distinguish between Series 2001 A, Series 2001 B bonds and conflicts with the bond agreements. Ultimately, the Government of Guam could be in breach of its obligations to the bond agreements. A synopsis of the laws and their potential legislative conflicts can be found in Attachments 4 and 5.

We recommend the GEDCA reexamine P.L. 26-03 and take the appropriate action to resolve any existing legislative conflicts with the bond agreements regarding the HAHS Fund.

Youth Tobacco Education and Prevention (YTEP) Fund

The YTEP Fund was established by P.L. 25-187 to receive \$2,147,995¹⁰ or 10 percent of the tobacco settlement asset-backed bonds proceeds for use by the Department of Mental Health and Substance Abuse (DMHSA). The YTEP Fund also receives 50 percent of fines and fees collected by DRT of penalties assessed on tobacco control¹¹.

As of September 30, 2003, the YTEP Fund had a fund balance of \$2,221,457¹² of which \$1,018,991 is from Series 2001 A bond proceeds and \$1,202,466 is from Series 2001 B bond proceeds. We determined that the DMHSA had not incurred any expenses during FY 2002 and 2003. The purpose of issuing bonds to make monies immediately available is defeated because the DMHSA has not utilized the YTEP Fund. The under-utilization of tobacco settlement asset-backed bond Funds is a similar problem faced by the DPHSS in the HAHS Fund. The DMHSA Clinical Services Administrator informed us that a plan was submitted to GEDCA in order to use the YTEP Fund, and according to GEDCA a draw down request, to utilize YTEP funds, was received in mid November 2003 from DMHSA.

As of June 30, 2004, the YTEP Fund has an available fund balance of \$814,755 from Series 2001 A bond proceeds. This amount will no longer be available for use by June 2005 because the proceeds will be converted to Series 2001 B bonds.

We recommend the DMHSA work in conjunction with the GEDCA, the DOA, and the Legislature to continue utilizing the YTEP Fund's available balance of \$814,755 to develop

¹⁰ Of the \$2.1 million, \$982,247 is from Series 2001 A bonds and \$1,165,748 is from Series 2001 B bonds.

¹¹ DRT collections are deposited directly to the General Fund and are presented in the GFPS as an inter-fund liability of \$14,545 to the YTEP Fund.

¹² This amount includes receivables of \$15,283.

youth compliance monitoring, tobacco and drug prevention and education programs and/or other related projects.

Health Security Trust (HST) Fund

The HST Fund was established for the purpose of funding the operations and capital expenditures of the GMHA. The HST Fund received \$10,739,977¹³ or 50 percent of the tobacco settlement asset-backed bonds proceeds.

As of 2003 fiscal year-end, the HST Fund had a fund balance of \$7,405,377 of which \$1,395,991 million is from Series 2001 A bond proceeds and \$6,009,386 is from Series 2001 B bond proceeds. During our review, we found that the GMHA was utilizing the Fund. As of June 2004, the remaining balance of \$960,001¹⁴ in Series 2001 A bond proceeds will no longer be available for use by June 2005 because of the bond conversion requirement. Therefore, we recommend the GMHA work in conjunction with the GEDCA, the DOA, and the Legislature to continue utilizing the HST Fund to finance the GMHA operations.

Although the law did not define the Fund's administrator, the DOA had accounted for and presented the HST fund as a fiduciary fund in the FY 2001 government-wide financial statements. However, the Fund had been erroneously omitted from the FY 2002 financial statements. The DOA Revenue Section Supervisor stated that the HST Fund was inadvertently omitted from the financial statements while transitioning from the ORACLE system to the AS400 financial management system in FY 2002. The Supervisor stated that the DOA would subsequently make the necessary adjustments to reflect the HST Fund in the FY 2003 government-wide financial statements. We recommend the Director of DOA retain the accounting responsibility for the HST Fund through FY 2004, but work in conjunction with the GEDCA, and the GMHA to transfer all accounting responsibilities of the HST Fund to GMHA, beginning in FY 2005, to ensure that all financial transactions are recorded.

University of Guam (UOG) Higher Education Endowment Fund

The UOG Fund was established for the purpose of managing and enhancing the learning resources and technology for the UOG. The Fund initially received \$3,221,993¹⁵ or 15 percent of the tobacco settlement asset-backed bonds proceeds.

As of 2003 fiscal year-end, the UOG Fund had a fund balance of \$2,217,312 of which \$415,085 is from Series 2001 A bond proceeds and \$1,802,227 is from Series 2001 B bond proceeds. During our review, we found that the UOG was utilizing the Fund. As of June 2004, the remaining balance of \$415,085 in Series 2001 A bond proceeds will no longer be available for use by June 2005 because of the bond conversion requirement. Therefore, we recommend the UOG President work in conjunction with the UOG Board of Regents, the GEDCA and the DOA to continue utilizing the UOG Fund to enhance the learning resources and technology at the UOG.

¹³ Of the \$10.7 million, \$4,911,236 is from the Series 2001 A bonds and \$5,828,740 is from Series 2001 B bonds.

¹⁴ According to P.L. 27-98, this remaining fund balance was appropriated for pharmaceutical and medical supply payments as of September 2004.

¹⁵ Of the \$3.2 million, \$1,473,371 is from Series 2001 A bonds and \$1,748,622 is from Series 2001 B bonds.

Because the enabling legislation did not specify the entity responsible in accounting for the UOG Fund, there has been confusion among officials from the GEDCA, the UOG, and the DOA as to who should be responsible for accounting for Fund. The GEDCA Public Finance Officer stated that GEDCA does not account for the UOG Fund because the Fund does not belong to the GEDCA. On the other hand, the former UOG Comptroller stated that only funds received by the UOG are accounted for and presented in the UOG financial statements because the UOG does not have sole custody of the UOG Fund.

In September 2004, we were subsequently informed by the DOA external auditor that since 2001 the UOG Fund had been improperly accounted for as a Debt Service Fund in the government-wide financial statements. The external auditor stated that corrective action was taken to address the error where the UOG Fund would be reflected as a special revenue fund in the FY 2003 government-wide financial statements.

Although the law did not assign the responsibility to account for the UOG Fund to any specific entity, we believe that the Government of Guam still has a fiduciary obligation for the UOG Fund. Therefore, we recommend the DOA, in its capacity as the central accounting unit for the Government of Guam, assume the accounting responsibility for the UOG Fund through FY 2004, but work in conjunction with the DOA, the GEDCA and the UOG to transfer all accounting responsibilities of the UOG Fund to UOG, beginning in FY 2005, to ensure that all financial transactions are recorded.

Guam Community (GCC) College Endowment Fund

The GCC Fund was established to provide funding for the management and enhancement of learning resources and technology for the GCC. The Fund was allocated \$3,221,993¹⁶ or 15 percent of the tobacco settlement asset-backed bonds proceeds.

In April of 2003, the GCC Administration and Board of Trustees developed a more comprehensive use for the GCC Endowment Fund, and through P.L. 27-011, the Legislature allowed GCC more flexibility and accessibility to the Endowment Fund by permitting the tobacco bond proceeds to fund capital improvement projects and expenditures. P.L. 27-011 also stated that all respective investment decisions associated with the Fund are made by the GCC Board of Trustees.

GCC maintains the accounting of the GCC Endowment Fund.¹⁷ As of 2003 fiscal year-end, the GCC Fund had a fund balance of \$3,330,714¹⁸ of which \$1,528,486 is from Series 2001 A bond proceeds and \$1,802,228 is from Series 2001 B bond proceeds. During our review, we found that the GCC was utilizing the Fund. As of June 2004, the remaining balance of \$1,212,759 in Series 2001 A bond proceeds has been substantially obligated.

¹⁶ Of the \$3.2 million, \$1,473,371 is from Series 2001 A bonds and \$1,748,622 is from Series 2001 B bonds.

¹⁷ The \$3.2 million was accounted for in the GCC FY 2001 audited financial statements. As of June 30, 2004 the GCC FY 2002, 2003, 2004 audited financial statements have not been completed.

¹⁸ This unaudited amount was derived from the GCC Endowment Fund Bank Statements.

Recommendations

We recommend the Director of the DOA:

1. Retain the accounting responsibility for the HST Fund through FY 2004 and work in conjunction with the GEDCA and the GMHA to ensure that all financial transactions are recorded.
2. Assume the accounting responsibility for the UOG Fund through FY 2004 and work in conjunction with the GEDCA and the UOG to ensure that all financial transactions are recorded.
3. Work in conjunction with the GEDCA, GMHA and UOG to transfer all accounting responsibility, of the HST Fund and UOG Fund, to GMHA and UOG respectively, beginning in FY 2005.

We recommend the Administrator of the GEDCA:

4. Re-examine P.L. 26-03 and take the appropriate action to resolve any existing legislative conflicts with the bond agreements regarding the HAHS Fund.
5. Work in conjunction with the DOA, GMHA, and UOG to clarify and transfer the accounting responsibilities of the HST and UOG Fund, to GMHA and UOG respectively, beginning in FY 2005.

We recommend the Director of the DPHSS:

6. Work in conjunction with the GEDCA, the DOA, and the Legislature to initiate a plan to utilize the HAHS Fund's available balance of \$1,600,960 to finance health care, tobacco prevention educational programs and/or other related projects.

We recommend the Director of the DMHSA:

7. Work in conjunction with the GEDCA, the DOA, and the Legislature to continue utilizing the YTEP Fund's available balance of \$814,755 to develop youth compliance monitoring, tobacco and drug prevention and education programs, and/or other related projects.

We recommend the Administrator of the GMHA:

8. Work in conjunction with the GEDCA, the DOA, and the Legislature to continue utilizing the HST Fund's available balance of \$960,001¹⁹ to finance the GMHA operations, ensuring that all expenditures are properly authorized by legislative appropriation prior to disbursement.

¹⁹ According to P.L. 27-98, this remaining fund balance was appropriated for pharmaceutical and medical supply payments in September 2004.

9. Assume the accounting responsibility of the HST Fund beginning in FY 2005' by working in conjunction with the DOA and the GEDCA to initiate and complete the transfer of accounting responsibilities.

We recommend the President of the UOG:

10. Work in conjunction with the GEDCA, the DOA, and the UOG Board of Regents to continue utilizing the UOG Fund's available balance of \$415,085 to enhance the learning resources and technology at the UOG.
11. Assume the accounting responsibility of the UOG Fund beginning in FY 2005' by working in conjunction with the DOA and the GEDCA to initiate and complete the transfer of accounting responsibilities.

Management Response

There was general concurrence with the findings and recommendations of the report by the Director of Administration, the Administrators of GEDCA and GMHA, and the Presidents of the UOG and GCC.

We appreciate the cooperation shown by the Department of Administration, the Guam Economic Development and Commerce Authority, the Department of Public Health and Human Services, the Department of Mental Health and Substance Abuse, the Guam Memorial Hospital Authority, the University of Guam, the Guam Community College, and the external auditors during our review.

The legislation, creating the Office of the Public Auditor, requires agencies to submit an action plan to implement audit recommendations within six months after report issuance. Accordingly, our office will be contacting you to provide the target date and title of the official (s) responsible for implementing the recommendations.

Senseramente,



Doris Flores Brooks, CPA, CGFM
Public Auditor

Attachments

Tobacco Settlement Asset-Backed Bond Proceeds
Bond Proceeds Summary

Sources of Funds

Par Amount	\$ 25,477,459
Original Issue Discount	<u>(46,152)</u>
Total Bond Proceeds	25,431,307

Uses of Funds

Operating Account	(50,000)
Debt Service Reserve Account	(1,893,216)
Cost of Issuance Fund	(882,257)
Capitalized Interest Account	(411,396)
Underwriting Discount	<u>(714,484)</u>
Total Bond Proceeds Available	<u>\$ 21,479,954</u>

Allocation of \$21.5 million in Bond Proceeds

DPHSS	10%	Health and Human Services Fund Series 2001 A	\$ 982,247
		Health and Human Services Fund Series 2001 B	<u>1,165,748</u>
			2,147,995
DMHSA	10%	Youth Tobacco Education and Prevention Fund Series 2001 A	982,247
		Youth Tobacco Education and Prevention Fund Series 2001 B	<u>1,165,748</u>
			2,147,995
GMHA	50%	Health Security Trust Fund Series 2001 A	4,911,236
		Health Security Trust Fund Series 2001 B	<u>5,828,740</u>
			10,739,977
UOG	15%	UOG Higher Education Endowment Fund Series 2001 A	1,473,371
		UOG Higher Education Endowment Fund Series 2001 B	<u>1,748,622</u>
			3,221,993
GCC	15%	GCC Endowment Fund Series 2001 A	1,473,371
		GCC Endowment Fund Series 2001 B	<u>1,748,622</u>
			3,221,993
			<u>\$ 21,479,954</u>

Note: Figures were rounded to the nearest dollar

**Schedule of Fund Activity and Balance
As of September 30, 2003**

Beneficiaries	HAHS Fund DPHSS	YTEP Fund DMHSA	HST Fund GMHA	UOG Fund UOG	GCC Fund GCC	Total
Settlement Proceeds	\$ 581,968	\$ -	\$ -	\$ -	\$ -	\$ 581,968
Series 2001 A						
FY 2001						
Bond Proceeds	\$ 982,247	\$ 982,247	\$ 4,911,236	\$ 1,473,371	\$ 1,473,371	\$ 9,822,473
Interest Earned	\$ 9,504	\$ 9,504	\$ 47,518	\$ 14,255	\$ 14,255	\$ 95,035
Amount Expended	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FY 2002						
Bond Proceeds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest Earned	\$ 17,393	\$ 17,393	\$ 53,977	\$ 24,406	\$ 26,089	\$ 139,258
Amount Expended	\$ -	\$ -	\$ (2,533,973)	\$ (650,000)	\$ -	\$ (3,183,973)
FY 2003						
Bond Proceeds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest Earned	\$ 9,847	\$ 9,847	\$ 18,037	\$ 8,054	\$ 14,770	\$ 60,554
Amount Expended	\$ -	\$ -	\$ (1,100,804)	\$ (455,000)	\$ -	\$ (1,555,804)
Series 2001 A Balance	\$ 1,018,991	\$ 1,018,991	\$ 1,395,991	\$ 415,085	\$ 1,528,486	\$ 5,377,544
Series 2001 B						
FY 2001						
Bond Proceeds	\$ 1,165,748	\$ 1,165,748	\$ 5,828,740	\$ 1,748,622	\$ 1,748,622	\$11,657,481
Interest Earned	\$ 4,541	\$ 4,541	\$ 22,705	\$ 6,812	\$ 6,812	\$ 45,411
Amount Expended	\$ (1,238)	\$ (1,238)	\$ (6,189)	\$ (1,857)	\$ (1,857)	\$ (10,522)
FY 2002						
Bond Proceeds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest Earned	\$ 20,091	\$ 20,091	\$ 97,542	\$ 28,680	\$ 28,680	\$ 195,083
Amount Expended	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
FY 2003						
Bond Proceeds	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Interest Earned	\$ 13,323	\$ 13,323	\$ 66,588	\$ 19,971	\$ 19,971	\$ 133,177
Amount Expended	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Series 2001 B Balance	\$ 1,202,466	\$ 1,202,466	\$ 6,009,386	\$ 1,802,227	\$ 1,802,228	\$12,020,630
Grand Total	\$ 2,803,425	\$ 2,221,456	\$ 7,405,377	\$ 2,219,170	\$ 3,330,714	\$17,980,142

Note: Figures were rounded to the nearest dollar.

**Schedule of Expendable Series 2001 A Balances
As of June 30, 2004**

Beneficiaries	HAHS Fund DPHSS	YTEP Fund DMHSA	HST Fund GMHA	UOG Fund UOG	GCC Fund GCC	Total
Balance as of 9/30/03	\$ 1,018,991	\$ 1,018,991	\$ 1,395,991	\$ 415,085	\$ 1,528,486	\$ 5,377,544
Expenditures*		\$ (204,236)	\$ (435,990)		\$ (315,727)	\$ (955,953)
Balance as of 6/30/04	\$ 1,018,991	\$ 814,755	\$ 960,001	\$ 415,085	\$ 1,212,759	\$ 4,421,590
Total Expendable Series 2001 A Balance		<u>\$ 4,421,590</u>				

* October 1, 2003 – June 30, 2004

Summary of HAHS Fund Legislation

<i>Effective Date</i>	<i>P.L.</i>	<i>Description</i>
April 1998	P.L. 24-174	The HAHS Fund was created to receive <i>Tobacco Litigation Settlement Proceeds</i> .
July 2000	P.L. 25-150	The enabling law of the HAHS Fund was repealed and reenacted to state that a fraction of the <i>Tobacco Litigation Settlement Proceeds</i> are assigned for the Reserve Fund for Non-Participating Tobacco Manufacturers.
January 2001	P.L. 25-187	The Legislature authorized GEDCA to securitize the <i>Tobacco Litigation Settlement Proceeds</i> for the issuance of bonds. It amended the HAHS Fund enabling legislation and created four new funds; all five funds were allotted certain percentages of the bond proceeds.
March 2001	P.L. 26-03	Repeals P.L. 25-150. The Legislature re-amended the HAHS Fund reverting the <i>Tobacco Litigation Settlement Proceeds</i> to be re-deposited into the HAHS Fund, as opposed to being securitized ²⁰ .
April 2001	P.L. 26-04	The Legislature irrevocably assigned the <i>Tobacco Litigation Settlement Proceeds</i> to GEDCA and for the securitization and issuance of bonds. ²¹

²⁰ Securitization means to buy (loans) from lenders, arrange them in groups, and issue bonds on the groups. In this case, the Government of Guam will sell their future interests in the tobacco settlement for a sum of money that is immediately available for use.

²¹ The assignment of the Tobacco Litigation Settlement Proceeds was concurrently assigned to the HAHS Fund and GEDCA by P.L. 26-03 and 26-04, respectively.

Conflicting Legislation

Conflict 1: Assignment of Tobacco Settlement Proceeds Confusing

We found that 5 G.C.A. §221108 (amended by P.L. 26-03) conflicts with P.L. 25-187 and P.L. 26-04 and the Legislature's decision to:

1. securitize²² a portion of the tobacco settlement proceeds for the issuance of tobacco settlement asset-backed bonds (P.L. 25-187) and
2. irrevocably assign all residual future interests in tobacco settlement proceeds to GEDCA (P.L. 26-04).

5 G.C.A. §221108 reflects the provisions outlined in P.L. 26-03, which specifically states:

“All proceeds entitled to Guam from the tobacco litigation settlement shall be deposited into the HAHS Fund established by this Act. All monies deposited into the HAHS Fund shall be expended exclusively for the purposes enumerated in 5 G.C.A. §221003 and the general intent of this Act.”

SOURCE: Amended by P.L. 25-150:17; 26-03:6

This legislative inconsistency may cause certain legal problems because while bondholders are led to believe that their bonds are backed up by the litigation proceeds, the laws of Guam indicate otherwise.

As illustrated in the excerpt above, within the “SOURCE” notation, the Compiler of Laws noted that 5 G.C.A. §221108 was amended by P.L. 25-150 and then by P.L. 26-03. However, 5 G.C.A. §221108 was in fact amended by P.L. 25-150, then by P.L. 25-187, and finally by P.L. 26-03. The “SOURCE” notation omitted any reference to P.L. 25-187. Based on this omission, it appeared that the Compiler of Laws was not able to update 5 G.C.A. §221108 when P.L. 25-187 became effective.

It is possible that the failure to update 5 G.C.A. §221108 to reflect the provisions of P.L. 25-187 may have caused the passing of P.L. 26-03. Our review of P.L. 26-03 showed that P.L. 26-03 failed to recognize the existence of P.L. 25-187. P.L. 26-03 instead made reference to P.L. 25-150 even though P.L. 25-150 was already repealed and reenacted by P.L. 25-187. Public Law 25-187 was a significant legislation because it clarified that the HAHS Fund should receive “bond proceeds” instead of “settlement proceeds.”

Conflict 2: Guam Law May Breach Bond Agreement

The HAHS Fund is a recipient of the tobacco settlement asset-backed bond proceeds and thus, should be managed and accounted for according to the requirements of the Series 2001 A and

²² Securitization means to buy (loans) from lenders, arrange them in groups, and issue bonds on the groups. In this case, it means that the Government of Guam will sell their future interests in the tobacco settlement for a sum of money that is immediately available for use.

Series 2001 B bonds. The HAHS Fund, however, is treated differently from the rest of the other bond proceed recipient funds because of P.L. 26-03.

Currently, the law for the HAHS Fund does not require a separate accounting of Series 2001 A and Series 2001 B proceeds. Furthermore, the law indicates that 80 percent of the HAHS Fund's balance can be expended upon Legislative approval. These provisions are inconsistent with the tax certificate²³ for Series 2001 B. The tax certificate requires that at least 95 percent of all Series 2001 B bond proceeds be reinvested. The Government of Guam accomplished this requirement through P.L. 25-187. However, P.L. 26-03 disregarded P.L. 25-187 and consequently, affected compliance with the tax certificate requirement.

²³ The tax certificate is a formal declaration of fact representing that Guam follows certain requirements, which determines that bonds issued are tax-exempt to bondholders.

Management Response



Felix P. Camacho
Governor
Kaleo S. Moylan
Lieutenant Governor

GOVERNMENT OF GUAM
(GUBETNOMENTON GUAHAN)
DEPARTMENT OF ADMINISTRATION
(DIPATTAMENTON ATMENESTRASION)
DIRECTOR'S OFFICE
(Uffisinan Direktot)
Post Office Box 884 • Hagatna, Guam 96932
• Tel (671) 475-1101/1250 • Fax: (671) 477-6788



Lourdes M. Perez
Director
Joseph C. Manibusan
Deputy Director

Orig: Dir
cc: Lora
file

October 15, 2004

Ms. Doris Flores Brooks, CPA, CGFM
Public Auditor of Guam
238 Archbishop Flores Street, Suite 401
Hagåtña, Guam 96910

Received by Office of the
Public Auditor

10/18/04 4:02 PM

Re: Tobacco Settlement Asset-Backed Bond Funds Draft Report & Management Letter

Dear Ms. Brooks:

In response to your October 4 letter, I would like to thank you for the opportunity to respond to the above-referenced draft report. Moreover, I also would like to commend your office and staff for a job well done.

The following are my comments in reference to the recommendations made to DOA as contained in the report:

1. I concur but with the following change:

DOA will work in conjunction with the GEDCA and the GMHA to continue accounting for the HST Fund through FY '04, however, this fund should be reported by GMHA in their FY '04 financials. Beginning in FY '05 GMHA will account for and report these funds in their financial statements.

2. I concur but with the following change:

DOA to assume the accounting responsibility until the end of FY '04 and work in conjunction with the GEDCA and the UOG to ensure that all financial transactions are recorded, however this fund should be reported in UOG's financials for FY '04. Beginning in FY '05, UOG will account for and include these funds in their financial statements.

I look forward to the final completion of the report. If you should have any questions, please feel free to write or contact my office at 475-1101.

Sincerely,

Lourdes M. Perez
Director

Aturidad Inadilanton



Ikunumihan Guahan

Governor
Felix P. Camacho

Lieutenant Governor
Kaleo S. Moylan

October 21, 2004

Doris Flores Brooks, CPA, CGFM
Public Auditor
Office of the Public Auditor
Suite 401, Pacific News Building
238 Archbishop Flores Street
Hagåtña, Guam 96913

Received by Office of the
Public Auditor

10/21/04 3:20PM

RE: Response to the Preliminary Draft Report of the Health and Human Services (HAHS) Fund and the Youth Tobacco and Education Prevention (YTEP) Fund, October 4, 2004

Dear Ms. Brooks:

We thank you for the opportunity to provide comment regarding the reference audit report as it pertains to the Health and Human Services (HAHS) Fund and the Youth Tobacco and Education Prevention (YTEP) Fund.

Specific to the recommendations to the Administrator of GEDCA, referenced below:

4. Re-examine P.L. 26-03 and take the appropriate action to resolve any existing legislative conflicts with the bond agreements regarding the HAHS Fund.

Response:

GEDCA concurs with the recommendation and will continue to work with Senator Lou A. Leon Guerrero, Chairwoman on the Committee on Rules and Health, to correct the legislation.

5. Work in conjunction with the DOA, GMHA, and UOG to clarify and transfer the accounting responsibilities of the HST and UOG Fund, to GMHA and UOG respectively, beginning in FY 2005

Response:

GEDCA concurs with the recommendation and will work with GMHA and UOG to assume accounting responsibilities of the HST and UOG Fund beginning in FY 2005.

The Authority is appreciative of the support your auditors have demonstrated to GEDCA's Public Finance Division throughout this audit. Should you have any questions concerning our response, please call Ms. Tina Garcia, Public Finance Officer at 647-4332 ext. 114.

Si Yu'os Ma'ase,

Michael Bamba
Acting Administrator

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CONFIRMATION



Guam Memorial Hospital Authority
Aturidât Espetât Mimuriât Guåhan



850 GOV. CARLOS CAMACHO ROAD
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TEL: 647-2444 or 647-2330
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MEMORANDUM

October 15, 2004

10/18/04 12:30 PM
Received by Office of the
Public Auditor *Rgn*

TO: Public Auditor
FR: Administrator/CEO
Cc: Chief Financial Officer
RE: HAHS/YETP Audit

.Guam Memorial Hospital management is in receipt of the above mentioned audit and has reviewed its findings and recommendations. Management is in concurrence with the audit and findings with regards to Guam Memorial Hospital. The actions suggested for the Hospital in the findings will be implemented effective the beginning of FY 05.

WILLIAM I. MCMILLAN, MBA CHE
HOSPITAL ADMINISTRATOR/CEO

SENT BY:UNIVERSITY OF GUAM** :10-22- 4 : 3:05PM :UOG EXECUTIVE OFFICE-

671 472 7951;# 2/ 2



UNIVERSITY OF GUAM
UNIBETSEDAT GUAHAN

OFFICE OF THE PRESIDENT
UOG Station, Mangilao, Guam 96923
Telephone: (671) 735-2990 • Fax: (671) 734-2296

October 22, 2004

Ms. Doris Flores Brooks
Public Auditor
Office of the Public Auditor
Suite 401, Pacific News Building
238 Archbishop Flores Street
Hagatna, GU 96910

Received by Office of the
Public Auditor

10/22/04 3:05 PM

Re: UOG's Higher Endowment Fund accounting responsibility (per your October 11, 2004 letter to Dr. Harold Allen, UOG President)

Dear Ms. Brooks:

In response to the above referenced letter, I concur with your recommendation to transfer accounting responsibility of the University of Guam Higher Education Endowment Fund to UOG.

The available balance in this fund as of the end of FY 2004 from the Series A fund was approximately \$.4M, which is expected to be expended before the June 2005 deadline.

This office is in the process of contacting both GEDCA and DOA to initiate a transfer of accounting responsibility from UOG to DOA. We recognize that this accounting responsibility will necessitate a transfer of these funds into an account under UOG's control. This account will be maintained separately from UOG's operating account. This process should be completed before December 31, 2004.

The UOG Comptroller, Ms. Francis Quinto, will be responsible for implementing this action.

Sincerely,

Dr. Harold Allen
President