

THE UNITED STATES VIRGIN ISLANDS
OFFICE OF THE VIRGIN ISLANDS INSPECTOR GENERAL



AUDIT REPORT

**AUDIT OF SELECTED LOAN PROGRAMS
ADMINISTERED BY
THE ECONOMIC DEVELOPMENT AUTHORITY**

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EXECUTIVE SUMMARY

The following summarizes the major findings from the Audit of Selected Loan Programs Administered by the Economic Development Authority (AR-01-EDA-13).

Finding 1: Loan Application Process (pages 5 to 10)

- ✓ Loans were processed without Economic Development Authority Governing Board approved policies and procedures as required by the Virgin Islands Code.
- ✓ No assurances that applicants had met loan eligibility requirements.
- ✓ At least \$1.8 million in secured loans were not protected because Uniform Commercial Code (UCC-1) liens were not filed or updated.
- ✓ More than \$72,824 was spent on a sole source contract entered into in violation of Title 29, Section 1107 of the Virgin Islands Code.

Finding 2: Loan Servicing (pages 11 to 15)

- ✓ Loan accounts were not properly serviced to ensure compliance with loan payment agreements and verification of borrower assets.
- ✓ Up-to-date demographics were not maintained for borrowers.
- ✓ Sufficient internal controls were not in place over collections and related payment entries to individual loan accounts.

Finding 3: Delinquencies (pages 16 to 22)

- ✓ More than 84.5% or, \$8.5 million, of the FY 2010 portfolio was deemed delinquent.
- ✓ High delinquencies were primarily due to ineffective collection practices, old loans assumed by the Economic Development Authority, and the absence of well-developed policies and procedures for liquidating likely uncollectible accounts.

Finding 4: Reporting (pages 23 to 24)

- ✓ Financial reports as required by the Virgin Islands Code were not submitted to the Banking Board of the Office of the Lieutenant Governor.



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April 2, 2013

Albert Bryan
Chairman
Economic Development Authority Board
Government Development Bank Building
1050 Norre Gade, Suite Number 5
Charlotte Amalie, Virgin Islands 00802

Dear Mr. Bryan:

This report contains the results of our audit of selected loan programs administered by the Economic Development Authority (Authority). The audit was initiated at the request of the Chief Executive Officer, and the objective was to determine if the Authority administered its loan programs in accordance with established laws, policies and procedures, and industry standards.

We found that the Authority did not administer its various loan programs effectively and in accordance with established laws and industry standards. Specifically, the Authority: (i) administered loans for an extended period based on policies and procedures not formalized through the Board as required by law; (ii) did not provide assurance that applicants had met certain loan eligibility requirements in that documentation supporting eligibility was unavailable in the files; (iii) did not always document or maintain updated claims against borrowers' assets by filing Uniform Commercial Code – Form 1 (UCC-1) liens; (iv) entered into a sole sourced contractual agreement with a vendor for a loan analysis and credit management software in violation of Title 29, Section 1107 of the Virgin Islands Code (Code) which requires competitive bidding; (v) did not properly service and follow-up on loan accounts to help ensure compliance with loan payment agreements and to verify borrower assets; (vi) did not adequately maintain files and up-to-date records of borrowers' addresses; (vii) did not ensure that there were sufficient internal controls over collections and payment entries to individual loan accounts; (viii) did not effectively pursue collection of delinquent loans; and, (ix) had an unusually high rate, 84.5%, of delinquent accounts. In addition, we found that the Authority did not submit, to the Division of Banking and Insurance of the Lieutenant Governor Office (Banking Board), financial reports for the GDB as required by law.

We attributed these conditions to: (i) ineffective Board and management oversight; (ii) the Authority's failure to follow Code requirements and industry standards regarding the administration of the various loan programs; (iii) the Authority's failure to effectively and consistently implement policies and procedures to adequately safeguard assets and services, and to collect outstanding loans; (iv) the old SBDA loans assumed by the Authority at the time of its creation; (v) the occasional use of unofficial loan liquidation policies and procedures; and (vi) the Authority's failure to follow reporting requirements as dictated by the Code

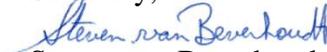
As a result: (i) there was no assurance that the overall objectives of the various loan programs were being effectively and efficiently achieved; (ii) at least \$1.8 million in secured loans requiring UCC-1 filings were not adequately protected; (iii) the Authority, as of October 25, 2011, had expended more than \$72,824 for a loan analysis and credit management software that was not used in any of the loan programs; (iv) the Authority lost management and inventory control over its loan portfolio which totaled over \$10.5 million; and, (v) the Authority lacked some level of accountability due to the non-submission of required financial reports.

We made several recommendations to address the conditions and causes cited in this report. Management was made aware of the conditions found during our audit and started to take corrective actions to address these issues. Our recommendations addressed the following areas: (i) the application and approval process; (ii) loan servicing; (iii) liquidation policies and practices for delinquencies and uncollectible accounts; and, (iv) reporting.

An exit conference was held on January 24, 2013, where there was agreement with the audit findings and recommendations. A response, dated March 7, 2013, was submitted by the Chief Executive Officer and is included as Appendix I. Additional information needed to close the outstanding recommendations is included as Appendix II.

If you require additional information, please call me at 774-6426.

Sincerely,



Steven van Beverhoudt, CFE, CGFM

V. I. Inspector General

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INTRODUCTION

BACKGROUND

The Virgin Islands Economic Development Authority (Authority) was established as a semi-autonomous governmental instrumentality of the Government of the Virgin Islands (Government) in February 2001, by Act No. 6390. It was established as an umbrella authority to assume, integrate and unify the functions of five subsidiary corporations: the Economic Development Commission (EDC), the Enterprise Zone Program (EZP), the Government Development Bank (GDB), the Industrial Park Development Corporation (IPDC), and the Small Business Development Agency (SBDA). Through these subsidiaries, the Authority is responsible for promoting and developing the economy of the Virgin Islands.

The Authority is governed by a seven-member Governing Board (Board) consisting of three non-government employees of the Virgin Islands or the United States and are appointed by the Governor with the advice and consent of the Legislature; three who are appointed by the Governor from among the heads of cabinet-level executive departments or agencies, or the Governor's executive staff; and one who is appointed from the Board or executive staff of the Virgin Islands Government Employee Retirement System, Virgin Islands Port Authority, or the University of the Virgin Islands. The Authority is managed by a Chief Executive Officer (CEO) who is appointed by the Board.

Two of the Authority's subsidiaries, the GDB and the SBDA, provide funding assistance through loan programs to the Virgin Islands business community. The GDB was established in 1978, but did not begin operations with required staff until 1997 when it received funding for the first time. Loan programs administered by the GDB include the Intermediary Relending Loan Program, the Micro-Credit Loan Program, the Economic Development Loan Program, the Tour Bus Leasing Program, and the Surety Bonding Program.

In addition, the GDB entered into a partnership with the Virgin Islands Energy Office and the Virgin Islands Water and Power Authority to finance a Loan/Rebate Program for home owners and small businesses to purchase and install solar water heaters.

The SBDA, established in 1969 by the Virgin Islands Legislature, provides low interest direct and guaranteed loans for the establishment of small businesses in the territory. Loan programs administered by the SBDA include: the Farmers and Fishermen Loan Program, the SBDA Direct Loan Program, the Frederiksted Loan Program, the Transportation Loan Program, and the Economic Development Administration Loan Programs 3801 and 3804, which are components of the U.S. Economic Development Administration. The SBDA is governed by the Loan Policy Board which consists of seven members who include the Commissioners of Tourism and Finance, the Authority's CEO, and four members of the Authority's Board.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of the audit was to determine if the Authority administered its loan programs in accordance with established laws, policies and procedures, and industry standards.

The scope was limited to the following nine loan programs administered by the GDB and SBDA during Fiscal Years 2009 and 2010:

- Intermediary Relending Loan Program
- Micro-Credit Loan Program - St. Croix
- Micro-Credit Loan Program - St. Thomas
- Farmers and Fishermen Loan Program
- SBDA Direct Loan Program
- Economic Development Administration Loan Program
- Frederiksted Loan Program
- SBDA 3801 Program
- SBDA 3804 Program

To accomplish our audit objective, we examined all available supporting documents to include application packages, promissory note agreements, collateral documents, loan payment and accounting records accessible in and on the Authority's physical and automated filing systems.

As part of our audit, we evaluated the loan application, servicing, collection, liquidation and reporting functions. This included observing the various processes and interviewing the Authority's management and Lending Division staff. We also evaluated the internal controls over the various lending functions controlled by the Authority to the extent necessary to accomplish the audit objective. Weaknesses in internal controls are discussed in the Audit Results section of the report.

We selected various samples in testing the Authority's effectiveness in asset management through their loan application processing, servicing, collections and liquidation practices.

We selected a judgmental sample consisting of 36 loans, valued at \$1,436,231, to test whether application processing procedures had been followed by the agency. We selected the sample from loans listed on the loan ledger reports. The dollar values of the loans were not a factor in the selection methodology.

We selected a judgmental sample consisting of 21 loans, originating in Fiscal Years 2009 and 2010 with outstanding balances totaling \$1,050,000, to determine the level of the Authority's loan servicing. We selected the sample from loans listed on loan ledger reports. Their dollar values were not a factor in the selection methodology.

We selected 31 open loans with outstanding balances of \$50,000 or more to confirm loan account balances and to test the accuracy of mailing addresses by mailing confirmation letters to the borrowers.

We selected 10 loans listed with outstanding balances of \$100,000 or more as of September 30, 2010, to determine if loans that were listed under the “Allowance for Uncollectable Loans” category on the Authority’s financial statements had been adequately serviced prior to that classification. These loans were valued at \$1,758,312.

We conducted the performance audit in accordance with the “Government Auditing Standard” issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. Accordingly, we performed such tests of available records and performed other auditing procedures that were considered necessary under the circumstances.

PRIOR AUDIT COVERAGE

We are unaware of any performance audits completed within the past five years that relate to the Authority’s loan programs. The Office of Inspector General, Department of the Interior, audited the SBDA of the Virgin Islands and issued a report in January 1997 (Report No. 97-I-257). The audit found that the “Agency: [i] did not always adequately verify and analyze data in loan application packages to determine the applicants’ credit worthiness, financial stability, and ability to repay the loans; [ii] did not always secure adequate collateral to protect the Government’s interest; and [iii] did not maintain an up-to-date record of outstanding loans, refer defaulted loans to a private collection agency or to the Virgin Islands Attorney General in a timely manner, and provide technical assistance to borrowers to help them better manage their business finances.”

The Office of Inspector General made recommendations related to the loan application and approval process and collection enforcement.

AUDIT RESULTS

CONCLUSIONS

The Authority did not administer its various loan programs effectively and in accordance with established laws and industry standards. Specifically, the Authority: (i) administered loans for an extended period based on policies and procedures not formalized through the Board as required by law; (ii) did not provide assurance that applicants had met certain loan eligibility requirements in that documentation supporting eligibility was unavailable in the files; (iii) did not always document or maintain updated claims against borrowers' assets by filing Uniform Commercial Code – Form 1 (UCC-1) liens; (iv) entered into a sole sourced contractual agreement with a vendor for a loan analysis and credit management software in violation of Title 29, Section 1107 of the Virgin Islands Code (Code) which requires competitive bidding; (v) did not properly service and follow-up on loan accounts to help ensure compliance with loan payment agreements and to verify borrower assets; (vi) did not adequately maintain files and up-to-date records of borrowers' addresses; (vii) did not ensure that there were sufficient internal controls over collections and payment entries to individual loan accounts; (viii) did not effectively pursue collection of delinquent loans; and, (ix) had an unusually high rate, 84.5%, of delinquent accounts. In addition, we found that the Authority did not submit, to the Division of Banking and Insurance of the Lieutenant Governor Office (Banking Board), financial reports for the GDB as required by law.

We attributed these conditions to: (i) ineffective Board and management oversight; (ii) the Authority's failure to follow Code requirements and industry standards regarding the administration of the various loan programs; (iii) the Authority's failure to effectively and consistently implement policies and procedures to adequately safeguard assets and services, and to collect outstanding loans; (iv) the old SBDA loans assumed by the Authority at the time of its creation; (v) the occasional use of unofficial loan liquidation policies and procedures; and, (vi) the Authority's failure to follow reporting requirements as dictated by the Code.

As a result: (i) there was no assurance that the overall objectives of the various loan programs were being effectively and efficiently achieved; (ii) at least \$1.8 million in secured loans requiring UCC-1 filings were not adequately protected; (iii) the Authority, as of October 25, 2011, had expended more than \$72,824 for a loan analysis and credit management software that was not used in any of the loan programs; (iv) the Authority lost management and inventory control over its loan portfolio which totaled over \$10.5 million; and, (v) the Authority lacked some level of accountability due to the non-submission of required financial reports.

We made several recommendations to address the conditions and causes cited in this report. Management was made aware of the conditions found during our audit and started to take corrective actions to address these issues. Our recommendations addressed the following areas: (i) the application and approval process; (ii) loan servicing; (iii) liquidation policies and practices for delinquencies and uncollectible accounts; and, (iv) reporting.

FINDING 1: LOAN APPLICATION PROCESS

The Authority did not effectively administer the application and approval process for its various loan programs. Specifically, the Authority: (i) processed loans without Board approved policies and procedures as required by law; (ii) did not provide assurance that applicants had met certain loan eligibility requirements in that documents supporting eligibility were not in the loan files; (iii) did not always document or update its claims against borrower assets by filing UCC-1 liens with the Government; and, (iv) entered into a sole sourced contractual and payment agreement with a vendor for a loan analysis and credit management software in violation of Title 29, Section 1107 of the Code.

We attributed these conditions to: (i) ineffective Board and management oversight of the application and approval process; (ii) the Authority's failure to follow the Code regarding the administration of the various loan programs; and, (iii) the Authority's failure to effectively and consistently implement policies and procedures to adequately safeguard assets.

As a result: (i) there was no assurance that the objectives and integrity of the application and approval process were achieved and preserved; (ii) at least \$1.8 million in secured loans requiring UCC-1 filings were not adequately protected; and, (iii) the Authority had expended more than \$72,824 for a loan analysis and credit management software that was not used.

Background

Titles 11 and 29 of the Code require that subsidiary corporations or programs of the Authority function under the direction of the Board. As the policy-making arm of the Authority, the Board is responsible for approving or denying applications for loans, and providing general administrative oversight of the programs. Under Title 11, Section 1253 of the Code, a seven member Loan Policy Board was created to administer the various loan programs and establish policies and guidelines for the approval or denial of SBDA loan applications. The Loan Policy Board is also performing the same functions for GDB loans. Based on the law, the Loan Policy Board is comprised of a combination of Board members appointed by the Governor and the Commissioners of Tourism and Finance.

The law and unapproved guidelines used by the Authority established eligibility criteria for applicants receiving loans. For instance, a prerequisite in receiving an SBDA secured loan requires that the borrower had made an effort to and failed to secure a loan from the private sector or from other governmental sources. For all loans, an application package must include, among other things, a copy of the borrower's Virgin Islands tax clearance letter, a current Virgin Islands business license, a business plan, and proof of legal residency of Virgin Islands. The borrower must also provide proof of having adequate insurance coverage on the life of the borrower and on the business assets, with the Authority being the primary beneficiary or loss payee, as applicable. In addition, a credit report is to be obtained for the borrower. There are also investment criteria that the applicant must meet. Specifically, the borrower must personally finance between 20 to 25% of the cost of the project.

Unapproved draft policy guidelines used by the Authority stipulate that “All loans shall be secured by first lien on business assets...when a first lien is not possible, other collateral will be considered based on the loan amount to be financed.” The guidelines state that the Authority’s collateral file system will contain all original documents to include UCC-1 liens. In the Virgin Islands, UCC-1 liens are filed with the Office of the Lieutenant Governor (Lieutenant Governor’s Office) and are valid for 5 years. They are renewable for the life of the loan.

Regarding purchasing and contracting by the Authority, Title 29, Section 1107 of the Code requires that the Authority follow competitive bidding procedures for the purchasing and contracting of supplies and services in excess of \$10,000. Exceptions are allowed for situations such as emergencies and sole provider.

Loan Policy Manual

The Authority used unapproved draft policies and procedures to administer the various loan programs. Management acknowledged that a loan policy manual drafted after the creation of the Authority had not been presented to the Board for approval. The unapproved manual was designed to comprehensively address the loan processing, underwriting, servicing, and liquidation aspects of the Authority’s loan operations. During our audit, we found that the Lending Division staff was not using uniform and structured procedures in the application and approval process and lacked effective supervision. In response to our request for policy documents, a senior loan officer provided us with a compilation of documents which included an assortment of memoranda, laws, acts, and informal policy and procedure excerpts, some dating back to 1985.

The lack of formalized and uniform procedures was linked to ineffective Board and management oversight. Although the creation of the draft manual was an effort to update the agency’s loan policy guidelines, management failed to act in formalizing it through the Board and ensuring that it was disseminated to and used by staff. Our audit found that these failures of supervision and inconsistent application of procedures by the Lending Division staff negatively affected the processing, servicing, collection, liquidation, and closing of loans. In an interview, management informed us that the draft policy manual would be presented to the Board for review and approval in the near future.

Loan Application Documents

The Authority did not provide assurance that borrowers had met certain eligibility requirements for receiving loans. We reviewed 36 loans, with financed amounts valued at \$1,436,231, to test whether application processing procedures had been followed by agency personnel. The testing included reviewing borrowers’ files to ascertain if the loan application packages had included all required documentation. Of the 36 files reviewed, 32 lacked 1 or more required pieces of documentation which were useful in protecting the Authority’s financial interests and in determining whether applicants had met loan eligibility requirements. Of the 32 files, valued at \$1,240,224, in which exceptions were observed, 14 showed no documented evidence of insurance having been acquired; 5 did not have copies of income tax returns, tax

clearance letters or, in some cases, had contained copies of delinquent tax letters; 3 contained no documentation that the borrowers, who had applied for secured loans, had first been denied for a loan from the private sector or from other Government sources; 3 contained no documentation that credit checks had been performed for the borrowers; and 5 showed no proof that the borrower had submitted a business plan or had met the investment requirement. In addition, 2 of the 36 files did not contain the loan application documents.

We found that 6 files did not document the legal Virgin Islands residency status of the borrowers. We also observed that 17 files contained no photo identification of the borrowers. Although not a requirement, it is an accepted industry standard to require proper identification to include photo identification of loan applicants. Not only does it facilitate the application verification process, it also facilitates the servicing and collections of loans. The documentation deficiencies in borrowers' files provided no assurance that agency staff had made sure that all required information had been submitted or that they had all the necessary information needed to perform an adequate application analysis or verification before submission to the Board.

UCC-1 Filings

For secured loans, the Authority was not consistent in documenting its claims against borrower assets by filing UCC-1 liens with the Lieutenant Governor's Office. As a result, the Authority was vulnerable to potential losses in that its financial interests were not always adequately protected.

As part of our audit, we requested the UCC-1 filing statuses for 31 open secured loans for St. Thomas borrowers totaling \$2,215,000. For the 31 loans, records showed that UCC-1 liens had not been filed for 22 loans valued at \$1,803,000. The remaining 9 loans valued at \$412,000 had valid UCC-1 liens on file at the Lieutenant Governor's Office. We note that 5 of the 9 expired in December 2012.

The inconsistencies in UCC-1 filing were attributed to management's failure to adequately monitor the process. The following table shows the UCC-1 status of the 31 loan files reviewed.

Schedule of UCC-1 Filing Status for Reviewed Loan Files		
Loan	Amount Financed	UCC-1 Status
1	\$302,000	No UCC-1 on file.
2	150,000	No stamped UCC-1 on file
3	150,000	No UCC-1 on file
4	150,000	No UCC-1 on file
5	108,000	No UCC-1 on file
6	100,000	No UCC-1 on file
7	100,000	No UCC-1 on file
8	100,000	No UCC-1 on file
9	100,000	No UCC-1 on file
10	75,000	No UCC-1 on file
11	53,500	No UCC-1 on file
12	50,000	No UCC-1 on file
13	50,000	No UCC-1 on file
14	50,000	No UCC-1 on file
15	50,000	No UCC-1 on file
16	44,000	No UCC-1 on file
17	40,000	No UCC-1 on file
18	32,000	No UCC-1 on file
19	30,000	No UCC-1 on file
20	27,500	No UCC-1 on file
21	25,000	No UCC-1 on file
22	16,000	No UCC-1 on file
Subtotal	\$1,803,000	
23	\$100,000	UCC-1 filed on 12/28/2007
24	50,000	UCC-1 filed on 01/28/2010
25	50,000	UCC-1 filed on 12/28/2007
26	50,000	UCC-1 filed on 10/22/2008
27	45,000	UCC-1 filed on 01/28/2010
28	40,000	UCC-1 filed on 12/15/2008
29	40,000	UCC-1 filed on 12/28/2007
30	20,000	UCC-1 filed on 12/28/2007
31	17,000	UCC-1 filed on 12/28/2007
Subtotal	\$412,000	
Total	\$2,215,000	

Loan Analysis Software

We found one instance where the then CEO entered into a sole sourced 5-year contractual relationship in violation of Title 29, Section 1107 of the Code, which mandates that the Authority use competitive bidding to acquire supplies and services costing over \$10,000. In March 2007, the then CEO purchased a loan analysis and credit management software circumventing the competitive bidding process and without Board approval. As a result, the

Authority became contractually bound to pay \$88,050 in set-up and usage fees for software that was subsequently rejected by the Board. The usage fee consisted of 20 equal quarterly installment payments, each totaling \$2,400, for the processing of 30 applications per quarter over the life of the contract. An additional \$80 charge, per application, applied for processing in excess of 30 applications per quarter.

Management indicated that the use of the software, designed to assist the Board in determining applicants' eligibility for loans, was rejected and not used in the agency because Board members did not feel comfortable using an electronic system to review loan application packages. Their position was that manual reviews were more personable and effective. They felt that the manual process allowed members more input in decision-making responsibilities related to determining applicants' eligibility for loans. However, in an interview, a senior loan officer indicated that the software was interactive in that it was programed to require input from a quorum of Board members through phases of the analytical process for each loan application package. In addition, system denials could be overridden by authorized personnel if unique circumstances warranted such action.

Based on payment documents as of October 25, 2011, the Authority had paid \$72,824 to the vendor. We asked management if attempts had been made to terminate of the contract. Management responded that attempts had been made, but the vendor required advance payment of all future amounts owed to release the Authority from the contract. The contract was in effect until September 20, 2012.

Recommendations

We recommend that the Board:

1. Review, revise and approve the draft loan policy manual for the Authority, ensuring that it is consistent with the relevant provisions of the Code.
2. Ensure that the CEO provides oversight consistent with the sections of the Code and approved guidelines governing loan program management.
3. Require that management ensures that eligibility requirements are met and that loan files include all required documents.
4. Ensure that all UCC-1 liens are filed timely and are kept current.
5. Require that management adheres to Title 29, Section 1107 of the Code when contracting for supplies and services and obtains approval from the Board.

Economic Development Authority's Response

The Chief Executive Officer of the Authority submitted a March 7, 2013 response to the audit recommendations made in this report. Although concurrence or non-concurrence was not indicated for each recommendation, there was an implied agreement to the findings and recommendations in this section of the report. Several exhibits supporting the response were included with the package sent. These exhibits are not attached to this report but are a part of the audit file.

Regarding Recommendation 1, it was stated that the Lending Division of the Authority submitted a Processing Manual to the Boards for both the GDB and the SBDA. Approval of the Manual was received from members of both Boards.

Recommendations 2 and 3 were indirectly addressed jointly. When the Authority indicated that as part of the interview process, all applicants are now required to provide supporting documents to determine eligibility for the respective loan programs. Procedures are now in place to include the criteria to be used in determining loan eligibility, and application supporting documents are maintained in each customer's file.

For Recommendation 4, the response indicated that all UCC-1 filings are current for the cases identified in the report, and through the Loan Ledger Reporting module, expiring UCC's can be identified on a monthly basis.

Finally, as it relates to Recommendation 5, it was stated that the Authority will follow all applicable laws and regulations.

V. I. Inspector General's Comments

As previously stated, although concurrence or non-concurrence for each recommendation was not indicated in the response, there was implied agreement with the findings and recommendations. Accordingly, we will consider the five recommendations in this section of the report to be resolved.

FINDING 2: LOAN SERVICING

The Authority did not properly service its loan portfolio. Specifically, the Authority did not: (i) properly service and follow-up on loan accounts to ensure compliance with loan payment agreements and verify borrower assets; (ii) adequately maintain files and up-to-date records of borrowers' demographics; and, (iii) ensure that there were sufficient internal controls over collections and related payment entries to individual loan accounts.

We attributed these conditions to the failure of the Authority to effectively and consistently implement policies and procedures to adequately service outstanding loans. As a result, the Authority lost some degree of control of its loan portfolio which, excluding penalties and interest, totaled over \$10.5 million.

Background

Unapproved draft loan servicing procedures of the Authority require loan officers to effectively and proactively manage the loan portfolio in order to minimize delinquencies and losses. In addition, the draft procedures require that a log be maintained of all contacts with the borrower (whether verbal or written) in the loan file. The procedures require that loan officers visit borrowers to ensure that the business is operational, the borrower is actively engaged in the business and that the collateral is in good working condition.

Borrower information is recorded and maintained through a computer software system, known as LoanLedger++, as well as, in file folders. For the physical filing system, borrowers' loan records are stored in three separate files: a case file, a collateral file, and a payment file. According to the draft loan portfolio policy, the case file should contain the customers' submitted financial and business plans, the collateral file is to contain the original promissory note, security agreement, and UCC-1 lien, and the payment file should contain the payment schedule and other related note and payment records.

Based on the Authority's September 30, 2010, Accounts Aging Report, the GDB and the SBDA had 453 open loans, in the nine loan programs audited, with a total loan portfolio value of \$10,523,490. A detailed schedule of the Accounts Aging Report and the related delinquencies is discussed in Finding 3: Delinquencies of this report.

Servicing and Monitoring

We found that the Authority's overall servicing of loans was inadequate. This was largely due to ineffective and inconsistent implementation of servicing and monitoring procedures. The files audited showed no evidence that the Authority had routinely worked or managed loan accounts to ensure timely payments by borrowers, protect its financial interest, and minimize loan defaults. We reviewed the files for 21 loans originating in Fiscal Years 2009 and 2010, to determine the effectiveness of servicing provided by the Authority. The loans consisted of 8 from St. Thomas and 13 from St. Croix. The loan principals ranged from \$10,000 to \$150,000

with a cumulative total of \$1,050,000. Our review of the borrowers' contact log records revealed that the Authority did not follow the prescribed draft procedures or best practices for loan servicing. Although some borrowers' monthly payments were several months in arrears, the records did not affirm that the borrowers had been contacted as required in an effort to remedy the delinquencies or to determine the reason for the delayed payments.

The exhibit below presents an aging of accounts receivable as of September 30, 2010, for the 21 loans reviewed. The exhibit shows that the number of past due payments for 11 of the 21 borrowers ranged from 2 to 10 payments with the past due payments for the delinquent borrowers totaling \$44,781. Based on loan records, there was no indication that the Authority had telephoned or sent collection notices to the borrowers at any time during the period of their delinquencies. The Authority's failure to initiate or maintain consistent contact with the borrowers contributed to the delinquent balances. Maintaining contact with borrowers allows for pro-active management of loan portfolios.

Schedule of Sampled 2009 and 2010 Loans Past Due Status				
Loan	Loan Date	Principal Amount	Number of Past Due Payments	Total Past Due Amounts
1	01/29/2009	\$50,000	10	\$9,440
2	04/28/2010	100,000	7	9,814
3	12/15/2009	25,000	6	2,832
4	10/22/2008	72,000	5	5,260
5	03/13/2009	50,000	4	3,752
6	02/23/2009	20,000	4	1,392
7	11/10/2009	100,000	3	4,205
8	10/10/2008	50,000	3	3,153
9	02/25/2009	35,000	3	1,983
10	05/28/2010	15,000	3	852
11	04/24/2009	100,000	2	2,098
12	11/20/2008	50,000	Current	-
13	01/14/2009	25,000	Current	-
14	02/06/2009	75,000	Current	-
15	11/10/2009	30,000	Current	-
16	02/24/2010	15,000	Current	-
17	04/07/2010	11,500	Current	-
18	05/25/2010	150,000	Current	-
19	05/28/2010	10,000	Current	-
20	06/24/2010	17,000	Current	-
21	07/06/2010	50,000	Current	-
Total		\$1,050,000		\$44,781

The servicing inadequacies noted above also preceded Fiscal Years 2009 and 2010. For example, we reviewed open loans administered under the Micro-Credit Loan Program. The Authority's Accounts Aging Report showed that as of September 30, 2010, 157 Micro-Credit loans, with a balance due of \$2,820,009, were outstanding. These loans were given between Fiscal Years 2000 to 2010. The aging reports showed that 110 or 70% of the 157 loans were past due from 31 to over 150 days. The monetary value of the 110 delinquent loans totaled \$1,999,239. Of the 110 loans, 93 were over 150 days past due with an outstanding balance of \$1,683,823. The subject of loan delinquencies is discussed in more detail in Finding 3: Delinquencies of this report.

Site Visits/Credit Reporting

The Authority did not implement additional servicing tools designed to promote borrower compliance with loan agreements and timely payments. Although draft policy guidelines specified that periodic site visits be made, we found that such visits were infrequent. During the audit, we received reports in response to our request for information documenting all site visits performed during the audit scope period. Although the provided reports were detailed and comprehensive, they only documented 4 site visits being done during the scope period.

In addition, the Authority had not been reporting the payment histories of borrowers to any credit bureau agency, a practice that would help promote loan collection. An Official indicated that the Authority was in the process of finalizing an agreement with one of the major credit bureaus to start reporting borrowers' payment activities on a monthly basis.

Confirmation Letters

We found that the Authority did not adequately maintain up-to-date mailing addresses for some of its borrowers. As a result, the agency lost contact with them which impacted its ability to effectively service and monitor the loans. To confirm loan account balances and test the accuracy of addresses, we selected 31 loan accounts with the highest outstanding balances to mail confirmation letters to borrowers. The outstanding balances totaled over \$3 million.

The result of our confirmation requests is as follows:

- 8 (or 25.8%) of the 31 mailed confirmation requests were returned as undeliverable.
- We received positive confirmations from borrowers on the outstanding balances for 3 (or 9.7%) of the 31 loan accounts.
- We received no responses from borrowers for 20 (or 64.5%) of the loan accounts.

Internal Controls Over Loan Payments

The Authority did not ensure that there were sufficient internal controls over the collection of loan payments and the recording of the payments into the individual loan account records maintained on the accounting software LoanLedger++.

When a borrower makes a loan payment, the collector accepts the payment from the individual and enters the information into the LoanLedger++ system to update the borrower's loan payment record. The LoanLedger++ system generates an unnumbered receipt for the payment. The collector also prepares a manual receipt which is attached to the system generated receipt. At the end of the day, the day's collections and the corresponding receipts are turned over to the loan assistant, who prepares the day's bank deposit. A summary of the day's collections is prepared from the LoanLedger++ system by the loan assistant.

On the surface and taking into consideration the limited staff, this system seems to provide some degree of internal controls over collections and loan account updates. However, there are some significant weaknesses in the system that should be addressed.

Firstly, the computer generated receipts are not numbered; therefore, there are no assurances that the collection information is entered into the system and is included in the day's LoanLedger++ summary, especially, taking into consideration, the Authority's very poor history of loan servicing and monitoring.

Secondly, the manual receipts are generic receipts bought from an office supply store, and although the receipts in the individual books are in sequence, the sequences per book may be different. In addition, there is no chain of custody over the sequencing of the books or records to show what books were issued and being used.

The computer generated receipt should be the official receipt for the payment transaction; however, the LoanLedger++ software should be adjusted to print sequentially numbered receipts. The manual receipts could be kept as a backup in the event that the computer system is temporarily down. However, official Government receipts should be used and controls should be implemented to secure the receipt books and to maintain a record of the numerical sequence of the receipts.

Recommendations

We recommend that the Board:

1. Require that management ensures that loans are serviced and monitored timely and in accordance with policy guidelines adopted by the Authority and that all contacts with borrowers are properly documented.
2. Ensure that regular site visits are performed to ensure compliance with loan agreements and to verify assets.
3. Implement reporting with credit bureau agencies to promote borrower accountability.
4. Ensure that all borrowers' demographic information is current.

5. Ensure that there are sufficient controls in place to protect the loan payment and loan account update process.

Economic Development Authority's Response

The Authority's response indirectly addressed four of the five recommendations made in this section of the report. Regarding Recommendations 1 and 2, it was indicated that new collection procedures include the issuance of coupon books, billing statements, and collection letters. In addition, field visits are conducted with field-visit logs created to record each borrower's information.

Regarding Recommendation 2, although no response was made in the initial submittal, later correspondence received from the Authority indicated that contact was made with a credit bureau to record borrowers' activities.

In response to Recommendation 4, it was indicated that information update letters were sent to borrowers requesting updated information. For borrowers that cannot be located, Lending staff is working with the Authority's Legal Department to research information on borrowers.

Finally regarding Recommendation 5, it was stated that internal controls are now in place segregating the duties and functions of the lending staff. In addition, numbered receipt books are now under the jurisdiction of the Accounting Department.

V. I. Inspector General's Comments

Although concurrence, or non-concurrence, for each recommendation was not indicated in the response, there was implied agreement with the findings and recommendations. Accordingly, we will consider four of the five recommendations in this section of the report to be resolved. We must consider Recommendation 3 as unresolved since it was not mentioned in the response.

FINDING 3: DELINQUENCIES

The Authority has an unusually high rate of accounts that are delinquent. More than 84.5% of the Fiscal Year 2010 loan portfolio, or as much as \$8.5 million, was deemed delinquent by the Authority. This was in part attributable to: (i) ineffective collection practices; (ii) old loans assumed by the Authority at the time of its creation; and, (iii) the absence of well-developed policies and procedures for liquidating likely uncollectible bad debt. This contributed to inefficient and ineffective management of the loan receivable assets.

Background

The draft loan servicing manual procedures requires the implementation of the following steps by collection officers to proactively manage the portfolio and minimize losses. For a loan:

- 15 days past due, a telephone call is to be made to the borrower requesting payment.
- 30 days past due, a standard letter is to be mailed to the borrower requesting payment within 15 days to bring the loan current.
- 60 days past due, a standard letter is to be mailed to the borrower requiring payment within 15 days and informing the borrower that the matter will be referred to legal counsel if payment is not received.
- 90 days past due, “senior staff...confer with legal counsel and issue a right to cure, which could include a new payment agreement.” If necessary, further legal steps are taken to protect the portfolio.
- The loan/collection officer is required to immediately identify loans that are 120 days and over past due and bring them to the attention of the supervisor. The draft procedures further states, “These loans shall be charged off [or written off] at amounts, based on collateral value, since they cannot be justifiable assets on [the Authority’s] balance sheet at fiscal year end.”

Authority officials also indicated that an unwritten policy considers loans that have not had any payment activity for 365 days as uncollectible.

Finally, Title 11, Section 1254(b)(2) of the Code, allows the Authority to pursue final collection by way of compromise provided, that any such compromise be subject to prior approval of the Loan Policy Board.

Delinquent Loans

Based on the Authority’s September 30, 2010 Accounts Aging Report, there were 453 loans in nine loan programs with a total outstanding value of \$10,523,490. The report indicated that 383, or 84.5% of the loans, valued at \$8,497,350, were past due for more than 30 days. Of these delinquencies, 365 loans, valued at \$7,986,724, were past due for more than 120 days. For the nine loan programs administered by the Authority, the loan delinquency ratios ranged from

33% to 100%. The table below summarizes the Authority's Accounts Aging.

ACCOUNTS AGING REPORT FOR SEPTEMBER 30, 2010											
Loan Program	Current		Delinquent				Total Delinquent		Total		Loan # Delinquency Ratio (%)
	1-30 Days	31-120 Days	121+ Days	Total Delinquent	Loan Portfolio	Loan Portfolio	Loan Portfolio	Loan Portfolio			
	#	Amount	#	Amount	#	Amount	#	Amount	#	Amount	
Intermediary Relending	2	\$60,814	2	\$90,025	8	\$444,956	10	\$534,981	12	\$595,795	83.3
Farmers and Fishermen	4	36,066	1	4,520	64	203,185	65	207,705	69	243,771	94.2
SBDA Direct	10	486,888	2	86,633	171	4,839,471	173	4,926,104	183	5,412,992	94.5
Micro-Credit (St. Thomas)	30	596,190	4	92,272	37	753,501	41	845,773	71	1,441,963	57.7
Micro-Credit (St. Croix)	17	224,580	8	137,667	61	1,015,799	69	1,153,466	86	1,378,046	80.2
Economic Development	2	295,631	1	99,509	0	0	1	99,509	3	395,140	33.3
SBDA 3801	3	242,734	0	0	11	320,656	11	320,656	14	563,390	78.6
SBDA 3804	2	83,237	0	0	5	291,867	5	291,867	7	375,104	71.4
Frederiksted	0	0	0	0	8	117,289	8	117,289	8	117,289	100.0
Total	70	\$2,026,140	18	\$510,626	365	\$7,986,724	383	\$8,497,350	453	\$10,523,490	84.5

Source: Consolidated Lending Accounts Aging Analysis for September 30, 2010 – V. I. Economic Development Authority

We reviewed in detail, 10 loans with outstanding principal balances of \$100,000 or more as of September 30, 2010. These 10 loans had a cumulative outstanding balance of \$1,758,312. Loan files reviewed showed that 1 billing statement was printed for each account in Fiscal Year 2010. The records also showed that prior to Fiscal Year 2010, the most recent statement generated for each of the 10 accounts was in Fiscal Year 2007.

In addition to the billing statements, 3 of the 10 accounts had documentation supporting other forms of collection activity from Fiscal Year 2007 to 2010. Collection activity for the 3 borrowers, referred to as Borrowers A, B and C, are as follows:

- Borrower A made an in-person visit in 2007.
- Telephone calls were made to Borrower B in 2007 and collection letters were sent in 2008 and 2009.
- A certified letter sent to Borrower C in 2007 was returned to the Authority as undeliverable.

The 10 loans reviewed had high delinquent balances in relation to their principal loan amounts. From the inception of these loans, in 2000 and 2001, the borrowers had not made substantial or consistent payments on the loans and the Authority had made little or no effort to collect on the delinquencies. For example:

- One borrower had two loans for \$150,000 each. The loans, which were disbursed in Fiscal Years 2000 and 2001, had September 30, 2010 delinquent balances of \$146,254 and \$149,326, respectively. The delinquent balances were 97.5% and 99.6% respectively of the principal loan amounts.
- A \$150,000 loan which was disbursed to a borrower in Fiscal Year 2001 had a delinquent balance of \$133,046 or 88.7% of the principal loan amount.
- Another \$150,000 loan disbursed to a borrower in Fiscal Year 2001 had a delinquent balance of \$123,738 or 82.5% of the principal loan amount.

As shown throughout the first two findings in this report and further demonstrated by the Accounts Aging Report, the failure to implement an effective collection and monitoring system has resulted in the high delinquency rate for the various loan programs; most of which were established as revolving or self-funding programs. The purpose of the revolving, or self-funding, programs was to allow for collections to be used to sustain the lending programs without continuous appropriations from the Legislature.

Although implementation of collection monitoring procedures does not guarantee that all loan payment agreements will be honored, effective implementation reduces the risks of defaults. The Authority had the responsibility to maximize the effectiveness of its collection efforts to reduce such risks. In addition, timely repayment of loan principal amounts and the related interest charges would have made more funds available to the business community in additional loans through the revolving fund programs.

Authority officials acknowledged the high delinquency rate of its portfolio and stated that plans had been initiated to address the problem. They informed us that they had obtained the services of two collection agencies to pursue collection on delinquent debts. Based on the professional services agreements, the Authority entered into contractual relationships with the agencies near to and just after the end of Fiscal Year 2010.

Uncollectible Accounts

According to Authority officials, loans that have not had any payment activity for 365 days are deemed uncollectible. Based on records provided, 316 loans, valued at \$6,996,442, were listed as delinquent at the end of Fiscal Year 2010. We have identified three basic categories of delinquent accounts to include, old SBDA loans, deceased borrowers, and identifiable borrowers.

Old SBDA Loans. Although loan agreements reviewed had terms ranging from 5 to 7 years, we found that as of September 30, 2010 the Authority's loan ledger listed open loans which were from 10 to almost 40 years old, some dating back to 1971.

The following exhibit summarizes delinquent loans predating the establishment of the Authority. The time period, number of loans, note amounts, and outstanding unpaid principal balances are given. As of the end of Fiscal Year 2010, there were 211 loans awarded between 1971 through the end of 1999 that had delinquent balances totaling almost \$3.7 million. The number of loans from the 1970s and 1980s totaled 50 and 97 with delinquent outstanding balances totaling about \$1.3 million and \$1.2 million, respectively. The payment inactivity on most of these accounts, coupled with the expired repayment terms, required that Authority have procedures in place to provide responsible guidance on closing out these accounts.

SUMMARY OF DELINQUENT LOANS APPROVED PRIOR TO 2000			
Time Period	Number of Loans	Original Amounts	Outstanding Balances
1970's	50	\$1,528,795	\$1,266,651
1980's	97	1,404,841	1,154,456
1990's	64	1,575,707	1,263,943
Total	211	\$4,509,343	\$3,685,050

Deceased Borrowers. The Authority has also been carrying on the loan ledger, balances for deceased borrowers. Specifically, the Authority listed 37 such loans, with a total balance of \$899,958, for which the last transaction dates ranged from 1976 to 2008.

SCHEDULE OF DECEASED BORROWERS			
Deceased Borrower	Loan Date	Principal Balance	Last Transaction Date
1	04/14/76	\$10,000	04/14/76
2	04/14/76	30,900	04/14/76
3	04/14/76	230	04/14/76
4	01/26/77	2,784	01/26/77
5	02/01/78	1,123	02/01/78
6	01/01/86	150	01/01/86
7	02/25/83	357	04/23/88
8	03/04/86	4,806	09/14/93
9	12/06/89	5,622	09/30/04
10	01/25/95	7,987	09/30/04
11	10/17/72	23,973	09/30/04
12	09/19/74	3,852	09/30/04
13	07/10/74	8,715	09/30/04
14	07/10/74	7,600	09/30/04
15	10/31/74	7,020	09/30/04
16	01/22/71	23,818	09/30/04
17	08/18/93	21,000	09/30/04
18	02/05/73	7,700	09/30/04
19	06/11/90	27,497	09/30/04
20	09/21/76	47,853	09/30/04
21	05/28/75	6,076	09/30/04
22	05/28/76	52,123	09/30/04
23	09/30/87	41,195	09/30/04
24	12/31/86	13,918	09/30/04
25	11/20/73	322,628	09/30/04
26	07/19/73	7,066	09/30/04
27	01/12/83	14,265	09/30/04
28	12/31/02	10,571	09/30/04
29	12/31/86	7,850	09/30/04
30	12/31/86	3,505	09/30/04
31	08/06/84	4,675	09/30/04
32	06/11/86	68,837	09/30/04
33	10/31/86	6,009	10/12/04
34	07/31/80	42,644	10/12/04
35	03/25/97	4,034	10/12/04
36	12/17/04	15,929	11/27/06
37	11/26/93	35,646	06/26/08
Total		\$899,958	

As an example, of the Authority's failure to act on a judicial judgment, a borrower had received 2 SBDA loans in 1973. As of the end of Fiscal Year 2010, the borrower had an outstanding balance of \$329,694 (\$322,628 + \$7,066). The borrower died sometime between 1980 and 1981 and SBDA had filed a "Creditor's Claim" on the borrower's estate in 1981 by which SBDA's motion was granted by the then Territorial Court of the U.S. Virgin Islands. However, there was no liquidation activity on the borrower's account for over 30 years.

Identifiable Borrowers. Although many of the delinquent loans were old or the borrowers were deceased, several loans to borrowers are collectible. We identified 14 loans, valued at \$1,856,743, to individuals to include former and present senators, and other business leaders in the community. Although, some of these loans date back to 1973, they are still carried on the Authority's loans receivable books under the "Allowance of Uncollectible Loans" category. For example:

- A current senator received an SBDA loan in 1985 in the amount of \$20,000. EDA's loan ledger records indicated that as of September 30, 2010, the principal balance due was \$8,449 with a total loan pay-off of \$21,464.
- A former senator received an SBDA loan in May of 1982 in the amount of \$100,000. EDA's loan ledger records indicated that as of September 30, 2010, the principal balance due was \$95,706 with a total loan pay-off balance of \$143,232.
- A prominent business person received 2 SBDA loans. One in August 2000 and the other in January 2001. Each loan was for \$150,000. For the August 2000 loan, EDA's loan ledger records indicated that as of September 30, 2010, the principal balance due was \$146,254 with a total loan pay-off of \$296,881. As for the January 2001 loan, the principal balance due was \$149,326 with a total loan pay-off of \$302,421.
- A prominent contractor received an SBDA loan in March of 1973 for \$75,852. According to EDA's loan ledger records as of September 30, 2010, the principal due was \$75,252, with a total loan pay-off of \$132,503.

As noted in the previous findings, inadequate loan servicing and collection monitoring contributed to the high delinquent balances. We also found that other factors contributing to the high delinquencies included the high number of old SBDA loans assumed by the Authority at its creation and the agency's failure to follow loan liquidation procedures for loans that were likely uncollectible. We were told that Board approval is required to write-off loan accounts. Although draft loan liquidation guidelines stipulate that loans 120 days and over are to be written-off, officials provided no specific steps for effectively and consistently implementing the policy through the Board.

Writing-off a loan does not mean that the bad debt is necessarily uncollectible or that the borrower is no longer obligated to repay the loan. However, the loan liquidation procedure helps to streamline the management of loan receivable assets.

Write-offs

The Authority ineffectively and inconsistently addressed the write-off of bad debt. We found that 9 loan accounts totaling \$87,541 were written off during Fiscal Year 2009, while no accounts were written-off during Fiscal Year 2010. Of the 9 accounts written-off during 2009, 8 were written-off because of the death of the borrowers and 1 was written-off because of the hardship of the loan on the elderly borrower. All 9 accounts were approved for write-off from the Board.

As part of our audit, we also examined loan account write-offs occurring before our audit scope period. We found that the Authority did not write-off any accounts during Fiscal Years 2000 through 2006. It did, however, write-off loan accounts during Fiscal Years 2007 and 2008. Eight accounts were written-off as uncollectible during 2007. Seven of these accounts, with balances of \$225,303, were written-off without Board approval. These accounts were written-off either as part of compromise agreements or because the balances were insignificant.

The Authority wrote-off as uncollectible a total of 28 accounts totaling \$721,369 in outstanding balances during Fiscal Year 2008. Twenty-seven accounts totaling \$714,893 were written-off because the borrowers were deceased, had filed bankruptcy, or because collection costs were assessed to be more than the amounts due.

One account with a principal balance of \$12,476 was settled for a payment of \$6,000 with the remaining balance of \$6,476 written-off as part of a compromise agreement. The loan modification and subsequent liquidation were done without Board approval.

During the audit, officials informed us that the Authority had written-off loans after Fiscal Year 2010 that were over 151 days delinquent and had started the loan modification process of refinancing loans in which the agency was receiving sporadic payments.

As demonstrated by the various situations shown in this section of the report and in conjunction with the lack of servicing and collection monitoring identified in the previous findings, some delinquencies should be liquidated. However, other loans classified as uncollectible are probably very much collectible. All outstanding loans should be properly researched and documented as to their collectability in accordance with formal liquidation policies and procedures. If they are determined to be uncollectible, they should be written-off in accordance with formal procedures and approval.

Recommendations

We recommend that the Board:

1. Establish policies and procedures for responsibly identifying uncollectible loans that could be liquidated to improve management of the loan portfolio and present a more accurate financial position of the Authority.

2. Require Authority officials to conduct timely due diligence to determine the collectibility of delinquent loan account. Adequately document the results of the collection actions and recommend for liquidation only those loans that are truly uncollectible.
3. Require that management receive approval from the Board for implementing loan modifications, write-offs, loan agreements, compromises, or other loan liquidation actions.

Economic Development Authority's Response

The response by the Authority inferred agreement with the findings and recommendations made in this section of the report. Regarding Recommendation 1, the approved rules and regulations establish a procedure for dealing with loans and delinquencies. In addition, new collection letters have been prepared. However, delinquencies over 150-days are referred to collection agencies, loans that remain delinquent are referred to the Legal Department for appropriate action.

Regarding Recommendation 2, loan officers are now aggressively working with borrowers to ensure that loans are paid on schedule. In addition a 90-day amnesty was granted to borrowers. All loans between 20-40 years, and are deemed uncollectible, will be referred to the Board of Directors for charge-off.

Finally, regarding Recommendation 3, the Board has approved the policies and procedures for liquidating uncollectible bad debts. These policies and procedures are currently being implemented and used by the Lending Division.

V. I. Inspector General's Comments

The Authority's indirect responses in this section of the report indicate agreement with the findings and recommendations made. We will consider them resolved. However, we do want to stress the need for complete due-diligence in reviewing the delinquent loans. As the report indicates the delinquency rate was over 84.5%. We do not agree with the collection process outlined in the response. To allow 150 days to pass before referring a loan to the Legal Department is not a good practice. Within 30 days of delinquency the loan officer must contact the borrower and start action. Within 60 days the Legal Department has to get involved. Then after all efforts have been exhausted, the loan is sent to an outside entity for collections. The outside entity usually keeps 33% of the collections as a fee. Why give the outside entity the delinquencies before the Legal Department does what they are supposed to do? Before any loans are referred to outside collection entities or written-off, every effort must be made to collect on the loans or to reestablish a payment schedule for individuals who can be contacted. These various loan programs should be revolving programs with loan and interest payments being used to fund the operations of the programs and to make funds available for other businesses to borrow.

FINDING 4: REPORTING

The Authority did not submit, to the Banking Board, financial reports for the GDB as required by law. As a result, the activities of the GDB had not been subject to an examination by the Banking Board. Timely examinations may have brought to the forefront the high delinquencies of the Authority, and forced management to take the necessary steps to resolve the high delinquency problems.

Background

Title 29, Section 904 of the Code requires the Authority to submit to the Governor, Legislature and Banking Board, a monthly report of the GDB's financial condition and total amount of outstanding loans. Also, Title 29, Section 905 of the Code requires the Authority to submit to the Banking Board an annual financial report. Additionally, Title 29, Section 906 of the Code, states that; "The Bank shall be subject to examination and supervision by the Banking Board of the Virgin Islands, in accordance with the terms of the Banking Law applicable to banks organized under or subject to the provisions thereof, however, that no fee shall be required to be paid by the Bank in connection with any such examination." Title 29, Section 907 of the Code states in part; "If, in consequence of an examination or a report made by an examiner, the Banking Board shall have reason to believe that the Bank is not in sound financial condition or that its affairs are conducted in such a manner as to endanger its funds or other assets, or if the Bank shall refuse to submit its books, documents and affairs for the inspection of any duly authorized examiner or if it shall fail to establish reserves as required by this chapter after thirty days' notice by the Banking Board, or if it should become insolvent in the judgment of the Banking Board the Banking Board shall report such facts to the Governor."

Annual Report Submission

We found that the Authority had not filed annual banking reports with the Banking Board for the GDB as required by the Code and subsequently GDB had not been considered for examination by the Banking Board. This was acknowledged by officials from the Authority and the Banking Board. After this short coming was brought to the attention of the Authority, an Authority Annual Report was sent to the Banking Board. However, this may not have fully complied with Titles 29, Sections 904 and 905 and Title 9, Section 64 of the Code, which requires reports to be filed under oath as to information submitted being true and in the format prescribed by the Banking Board. Officials of the Banking Board were not aware of the reporting requirements of the Authority, and need for their subsequent examination of the Authority's banking operations. As a result, there have not been any bank examinations of the GDB.

Timely bank examinations by the Banking Board would have included the monitoring of the GDB's internal controls and procedures used to protect assets through timely, effective and efficient monitoring of loan servicing and collections. Additionally, the high loan delinquency rate may have been avoided if timely filing of Authority reports with the Banking Board and

subsequent timely bank examinations had been performed. This could have allowed for bank examinations to reveal the conditions causing the high loan delinquency at an earlier time, and permit prompt corrective actions by the Authority. Also, the possible insolvency status of the Authority's loan programs resulting from the 84.5% delinquent loans ratio might have been avoided, or at least, discovered early enough to reduce the large amount of potentially lost loan collections, and lessened the loan programs' unsound financial condition.

Recommendations

We recommend that the Board:

1. Direct the Authority's management to immediately come into compliance with Code and file the required reports with the Banking Board and continue thereafter as required by law.
2. Request the Banking Board to schedule an examination of the bank operations as soon as possible.

Economic Development Authority's Response

Regarding the two recommendations made in this section of the report, the Authority only responded to Recommendation 1, indicating that they are now in compliance with the reporting requirements of Title 29 and Title 9 of the Virgin Islands Code.

No response was made regarding Recommendation 2, to request that an examination of the bank operations be made to the Banking Board.

V. I. Inspector General's Comments

We will consider Recommendation 1 in this section of the report to be resolved, although we do request that a copy of the most recent report filing be submitted to support the assertion.

Regarding Recommendation 2, since it was not addressed in the response, we must consider it unresolved.

ECONOMIC DEVELOPMENT AUTHORITY'S RESPONSE



March 7, 2013

Steven Van Beverhoudt
Virgin Islands Inspector General
Office of the V. I. Inspector General
2315 Kronprindsens Gade #75
Charlotte Amalie, V.I. 00802-6468

Re: *VIEDA Lending Division Audit Response*

Dear Mr. Van Beverhoudt:

In following-up to your audit findings on your inspection of the Government Development Bank (GDB), we have prepared the attached corrective actions with supporting documentations.

We kindly ask that prior to your final release, that you afford us the opportunity to review your final document before it is made public.

Thank you.

Sincerely,


Percival E. Clouden
Chief Executive Officer

Inspector General's Note: Exhibits attached with the response are not included with the report.

**ECONOMIC DEVELOPMENT AUTHORITY'S
RESPONSE
RESPONSE TO AUDIT REPORT FINDINGS
GOVERNMENT DEVELOPMENT BANK
SMALL BUSINESS DEVELOPMENT AGENCY
MARCH 07, 2012**

In response to the Audit of Selected Loan Programs Administered by The Economic Development Authority we wish to provide the following responses to the Audit findings.

AUDIT FINDING I: LOAN APPLICATION PROCESS

1. Processed Loans without Board Approved Policies and Procedures as required by Law.

CORRECTIVE ACTION:

The Lending Division presented the Lending Division Processing Manual, which is divided into three (3) parts to include the Loan Processing, Loan Servicing, and Loan Liquidation sections to Board members for approval. The Board members for both the Small Business Development Agency (SBDA) and Government Development Bank (GDB) duly approved the respective Resolutions that are now being in use. (See Exhibit A)

2. Did not provide assurance that applicants had met certain loan eligibility requirement in that documents supporting eligibility were not in the loan files.

CORRECTIVE ACTION:

As part of the interviewing process all applicants are required to provide supporting documents to determine loan eligibility as required by the respective loan programs. We have now put in place procedures including the criteria to determine loan program eligibility in our loan write-up, and is evidenced by supporting documents maintained in each of the customer file. (See Exhibit B)

3. Did not always document or update its claims against borrower assets by filing UCC-1 liens with the Government.

CORRECTIVE ACTION:

We have filed all the twenty-two (22) cases identified on the report in addition to the other nine (9) cases identified in the audit. The UCC-1 filings and UCC-3 filings are an integral part of our Lending Division processes. We are now able to identify expiring UCC's through our monthly Loan Ledger Reporting module. (See Exhibit C)

ECONOMIC DEVELOPMENT AUTHORITY'S RESPONSE

4. **Entered into a sole sourced contractual and payment agreement with a vendor for a loan analysis and credit management software in violation on Title 29, Section 1107 of the Code.**

CORRECTIVE ACTION:

The VIEDA is committed to following all applicable laws and regulations.

AUDIT FINDING II: LOAN SERVICING:

1. **Properly service and follow-up on loan accounts to ensure compliance with loan payments agreement and verify borrower assets.**

CORRECTIVE ACTION:

To ensure compliance with the proper servicing of loans we employ a combination of collection activities. These include the issuance of coupon books, billing statements, and collection letters. We conduct field visits and created a field-visit log to record each borrower's information, such as their location, mailing address, telephone numbers and any other pertinent information. (See Exhibit D – Collection Letters, Field Visit Log, Billing Statement)

2. **Inadequate file maintenance and up to-date records of borrowers' demographics.**

CORRECTIVE ACTION:

In order to keep borrowers' information current, letters are sent requesting updated information (See Exhibit E). The Lending staff is also working in conjunction with the Legal Department to research information on borrowers that cannot be located for whatever reason.

Ensure that there are sufficient internal controls over collection and related payment entries to individual accounts.

CORRECTIVE ACTION:

Internal procedures are in place segregating the duties and functions of the lending staff relative to the control over the receipt and posting of loan payments, (See Exhibit F). Also the distribution and control of numbered Receipt Books are now under the jurisdiction of the Accounting Department.

AUDIT FINDING III: DELINQUENCIES:

1. **Ineffective Collection Practices.**

ECONOMIC DEVELOPMENT AUTHORITY'S RESPONSE

CORRECTIVE ACTION:

Loan Officers are now aggressively working with borrowers to ensure they pay their loans on schedule. New collection letters have been designed advising delinquent borrowers of loan payment status showing 30, 60, 90, 120 days aging schedules. (See Exhibit G).

Delinquent loans over 150-days are now placed on Non-Accrual Status and are transferred to the collection agencies. Accounts returned from the agency for un-collectability are referred to our Legal Department for appropriate action.

2. High Delinquency due to Old loans assumed by the Authority at the time of its creation.

CORRECTIVE ACTION:

The Lending Division has taken proactive measures to collect on these delinquent borrowers. A 90-day Amnesty was granted to those borrowers in addition to the publication of collection notices in the local newspapers. (See Exhibit H). All loans between 20 – 40 years, and are deemed uncollectible, will be referred to the Board of Directors for charge-off during the third quarter of this fiscal year. (See Exhibit I)

3. The absence of well developed policies and procedures for liquidating likely uncollectible bad debt.

CORRECTIVE ACTION:

The Board has approved the respective Resolutions that document lending policies and procedures for liquidating uncollectable bad debts. These policies and procedures are currently being implemented and used by the Lending Division.

AUDIT FINDING IV: REPORTING:

1. Reports to Banking and Insurance (Financial Statements – GDB and SBDA)

CORRECTIVE ACTION:

The Authority's management is now in compliance with VIC, Title 29 Section 904 and 905; and Title 9 Section 64.

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ECONOMIC DEVELOPMENT AUTHORITY'S RESPONSE



March 22, 2013

Steven Van Beverhoudt
Virgin Islands Inspector General
Office of the V.I. Inspector General
2315 Kronprindsens Gade # 75
Charlotte Amalie, V. I. 00802-6468

Re: **VIEDA Lending Division Audit Response**

Dear Mr. Van Beverhoudt:

We are forwarding our response to Audit Finding 2: Loan Servicing, [Site Visits/Credit Reporting](#), specifically to:

"In addition, the Authority had not been reporting the payment histories of borrowers to any credit bureau agency, a practice that would have helped promote loan collection. An Official indicated that the Authority was in the process of finalizing an agreement with one of the major credit bureaus to start reporting borrowers' payment activities on a monthly basis"

Corrective Action:

We are aggressively pursuing a relationship with Trans Union who has been testing our processes. However, there has been some delay for final implementation of the reporting mechanism due to technical difficulties in accepting and reporting on corporate entities and guarantors. The Authority's IT consultant is currently exploring alternative credit reporting mechanisms, such as Dunn and Bradstreet, to effectively strengthen the credit reporting initiatives and capabilities.

We thank you for the opportunity to respond to your findings and recommendations. The Authority has already taken positive steps to improve its loan programs in accordance with established laws, policies and procedures, and industry standards.

Sincerely,

Percival E. Clouden
Chief Executive Officer

ADDITIONAL INFORMATION NEEDED TO CLOSE RECOMMENATIONS

<u>Recommendation Number and Status</u>	<u>Additional Information Needed</u>
Finding 1:	
1-1 Resolved	No further action needed.
1-2 Resolved	No further action needed.
1-3 Resolved	No further action needed.
1-4 Resolved	No further action needed.
1-5 Resolved	No further action needed.
Finding 2:	
2-1 Resolved	No further action needed.
2-2 Resolved	No further action needed.
2-3 Unresolved	Provide update on credit bureau agreement.
2-4 Resolved	No further action needed.
2-5 Resolved	No further action needed.
Finding 3:	
3-1 Resolved	No further action needed.
3-2 Resolved	No further action needed.
3-3 Resolved	No further action needed.
Finding 4:	
4-1 Resolved	No further action needed.
4-2 Unresolved	Provide documents to show examination request.

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