REPORT TO

THE CONGRESS OF THE UNITED STATES

REVIEW OF
THE SALE OF
FEDERALLY OWNED ELECTRIC POWER
AND
SALT WATER DISTILLATION FACILITIES
TO THE GOVERNMENT OF THE VIRGIN ISLANDS

VIRGIN ISLANDS CORPORATION
DEPARTMENT OF THE INTERIOR
GENERAL SERVICES ADMINISTRATION

BY

THE COMPTROLLER GENERAL
OF THE UNITED STATES

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COMPTROLLER GENERAL OF THE UNITED STATES
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To the President of the Senate and the
Speaker of the House of Representatives

Our Office has reviewed the sale of electric power and salt water distillation facilities, owned by the Virgin Islands Corporation, to the Government of the Virgin Islands.

We are presenting in this report, for the information of the Congress, the details, circumstances, and legal background which gave rise to our opinion that section 4(f) of the Virgin Islands Corporation Act (48 U.S.C. 1407c(f)) did not provide authority for the disposal of the electric power and salt water distillation facilities. Our report also describes the subsequent actions by the Virgin Islands Corporation and the General Services Administration, which have resolved our objection to the legal authority for this disposal.

In addition, our report includes comments concerning the adequacy of the appraisal of the electric power and salt water distillation facilities that was obtained by the General Services Administration and the need for improvement in appraisal evaluations by the Administration's appraisal review staff.

On May 28, 1965, the Virgin Islands Corporation entered into an agreement for the sale of its electric power and salt water distillation facilities to the Government of the Virgin Islands, citing as its authority section 4(f) of the Virgin Islands Corporation Act, for $6.5 million which was the amount at which the facilities had been appraised as of September 30, 1964, by a private engineering firm employed by the General Services Administration.

This amount was adjusted to reflect changes in plant investment and current assets between September 30, 1964, the appraisal cutoff date, and May 31, 1965, the transfer date. The adjusted price established pursuant to provisions of the contract of sale was $7,296,765 and resulted in a net loss, recorded in the Corporation's accounting records, of $2,861,119.

In our report to the Congress dated March 2, 1966 (B-114822), on the examination of the financial statements of the Virgin Islands Corporation for the fiscal year ended June 30, 1965, we stated that, in our opinion, this sale was an unauthorized disposal of corporate assets because section 4(f), which authorizes the Corporation to acquire and dispose of property in the ordinary and normal course of conducting its business affairs, could not be considered as authority for the Corporation to sell assets when the sale results in the termination of an authorized corporate activity, as was the result in the sale of the electric power and salt water distillation facilities.

On April 16, 1966, the Corporation's Board of Directors authorized its Chairman, with the concurrence of the Governor of the Virgin Islands, to take such steps as might be necessary to accomplish the sale of the water and power facilities to the Government of the Virgin Islands. Subsequently, the Corporation requested the General Services Administration to attempt to make such a sale under the provisions of the Federal Property and Administrative Services Act of 1949, as amended.

The Governor of the Virgin Islands and the General Services Administration renegotiated the original sales price to make adjustments on the basis of comments by our Office and the Chairman, Government Activities Subcommittee of the Committee on Government Operations, House of Representatives, concerning the reasonableness of the appraisal of the facilities at an estimated fair market value of $6.5 million.

On January 26, 1967, the General Services Administration agreed to sell the facilities to the Government of the Virgin Islands for $9.5 million, or about $2.2 million more than the original transfer price. In view of the reconveyance of the facilities to the Government of the Virgin Islands in accordance with provisions of the Federal Property and Administrative Services Act of 1949, as amended, we believe that the sale now has proper legal authority.

On the basis of our examination into the appraisal firm's determination of the estimated fair market value which was used as the price at which the General Services Administration initially proposed to sell the

Virgin Islands Corporation's electric power and salt water distillation facilities to the Government of the Virgin Islands, we believe that the Administration did not adequately review the private engineering firm's appraisal report on which the selling price was based.

In commenting on the determination of the estimated fair market value of the electric power and salt water distillation facilities, the General Services Administration generally disagreed with the conclusions set forth in this report and stated that it had decided, as a matter of judgment, that the conclusions set forth in the appraisal report were reasonable.

We believe, however, that, had an adequate evaluation of the appraisal firm's justifications been made, it would have become apparent to the General Services Administration that there was inadequate support regarding certain aspects of the appraisal and that the appraisal firm should be requested to submit an adequately supported revised estimated fair market value giving appropriate consideration to all pertinent factors relating to the marketability of the facilities.

Therefore, we are recommending that the Administrator of General Services emphasize to the Administration's appraisal review staff the need for appraisal reports to contain supporting data which fully describe the factors considered in estimating fair market value, such as economic obsolescence and projected net income, and the basis for arriving at the increase or reduction in value attributable to each factor.

In our opinion, the position of the Government Activities Subcommittee of the House Committee on Government Operations concerning the reasonableness of the original appraisal of the facilities at an estimated fair market value of $6.5 million, as expressed in a letter of February 13, 1965, from the Honorable Jack Brooks, Chairman of the Subcommittee, to the Administrator of General Services, and the continued interest of the Subcommittee played a highly important part in the decision in 1966 to renegotiate the sale of the property under the Federal Property and Administrative Services Act of 1949, rather than under the Virgin Islands Corporation Act, and in the sale price being increased by about $2.2 million.

Copies of this report are being sent to the Director, Bureau of the Budget; the Administrator of General Services; and to the members of the Board of Directors of the Virgin Islands Corporation.

Comptroller General
of the United States

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INTRODUCTION

The General Accounting Office has made a review of the sale of electric power and salt water distillation facilities, owned by the Virgin Islands Corporation, to the Government of the Virgin Islands. Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We reviewed a private engineering firm's appraisal report on the facilities, appraisal review procedures of the General Services Administration (GSA), pertinent laws and legislative history in support of such laws, and the action taken by the Corporation's Board of Directors to dispose of the facilities. This review was made because we had noted, during our audit of the Virgin Islands Corporation, certain circumstances which led us to question the fair market value assigned to the facilities and the legal authority cited for the disposal of the facilities.

BACKGROUND

The electric power and salt water distillation facilities in the Virgin Islands were owned and operated by the Virgin Islands Corporation, a wholly owned Federal Government corporation created by the Virgin Islands Corporation Act (63 Stat. 350; 48 U.S.C. 1407). On October 23, 1963, the electric power and salt water distillation facilities were declared by the Corporation as excess for transfer to the Government of the Virgin Islands under the provisions of section 203(e)(3)(H) of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 484(e)(3)(H)), which permit the transfer of surplus Federal property to territories on a negotiated basis in return for its estimated fair market value.

The book value of the electric power and salt water distillation facilities (acquisition cost less accumulated depreciation) and related accounts receivable and materials and supplies was about $10.2 million at May 31, 1965, the effective date of the sale.

At May 31, 1965, the Corporation's electric power system comprised two independently operated divisions, one located on the Island of St. Thomas and the other on the Island of St. Croix, which provided the generation and distribution of electric power for use throughout the Virgin Islands. The St. Thomas division had one steam-turbine generating unit and seven diesel generating units, having a combined capacity of 11,800 kilowatts. In addition to having generation and distribution facilities, the St. Thomas division had salt water distillation facilities which were designed to produce 275,000 gallons of potable water a day. The salt water distillation facilities were installed for integrated operation

with the steam-turbine generating unit. A boiler plant provided steam for the steam-turbine generating unit and the salt water distillation operations.

The St. Thomas division provided electric power for the Island of St. Thomas and the neighboring islands of St. John, Hassel, and Water. The St. Croix division, which provided power solely for the Island of St. Croix, had nine diesel generating units having a combined capacity of 9,242 kilowatts.

A private engineering firm was employed by GSA to appraise the properties declared excess by the Corporation and to prepare a report thereon setting forth its determination of the fair market value of the facilities. The firm carried out its field work during January and February 1964 and on March 20, 1964, submitted to GSA its appraisal report which contained the conclusion that the estimated fair market value of the facilities as then constituted was $5 million.

Because of additional investments by the Corporation, including primarily the purchase and installation in September 1964 of a new diesel generating unit, the engineering firm was employed by GSA to perform additional appraisal work. On September 30, 1964, the firm submitted to GSA an addendum to its original appraisal report, which contained the conclusion that the fair market value of the facilities for use in place as then constituted was $6.5 million. GSA accepted the appraisal as representing the estimated fair market value.

By letter dated October 29, 1964, to GSA, the Governor of the Virgin Islands offered to purchase the facilities for the appraised value.

We examined into the proposed transfer of the Corporation's electric power and salt water distillation facilities to the Government of the Virgin Islands, and, as a result, we advised the Deputy Administrator of GSA, by letter dated November 10, 1964, of several observations which caused us to question the reasonableness of the appraisal of the facilities at an estimated fair market value of $6.5 million. We provided copies of our letter to the Committees on Government Operations and Committees on Interior and Insular Affairs of the United States Senate and the House of Representatives.

By letter dated January 8, 1965, the Acting Administrator of GSA replied to our letter but did not comment on our specific observations. The Acting Administrator advised us that GSA had, in effect, relied on the experience and professional judgment of the private engineering firm. The Acting Administrator also attached copies of letters which expressed the views of the private engineering firm, the Department of the Interior, and the attorney for the Government of the Virgin Islands on our November 10, 1964, letter to GSA. These comments were given consideration in the preparation of this report.

On January 8, 1965, GSA submitted statements to the Senate and House Committees on Government Operations, in which it proposed that the Virgin Islands Corporation's electric power and salt water distillation facilities be sold to the Government of the Virgin Islands at the appraised fair market value of $6.5 million. These statements were submitted in accordance with the provisions of section 203(e) of the Federal Property and Administrative Services Act of 1949, as amended, which require that an explanatory statement of circumstances of each disposal by negotiation of any real or

personal property having a fair market value in excess of $1,000 be prepared and transmitted to the appropriate committees of the Congress.

On February 13, 1965, the Chairman, Government Activities Subcommittee of the House Committee on Government Operations notified GSA that the records used in the appraisal report indicated a value substantially in excess of the proposed selling price. The Chairman advised GSA also that the proposed sales price of $6.5 million did not represent the full value of the facilities which the United States was entitled to receive. On April 9, 1965, the Acting Administrator of GSA notified the Chairman of GSA's conviction that the proposed sale complied with the requirements of the Federal Property and Administrative Services Act of 1949, as amended, and that $6.5 million represented the fair market value of the property.

On May 12, 1965, the Secretary of the Interior, as Chairman of the Corporation's Board of Directors, authorized the withdrawal of the electric power and salt water distillation facilities from the status of excess property. The Acting Administrator of GSA, on May 27, 1965, approved the withdrawal.

The Secretary of the Interior advised the other members of the Corporation's Board of Directors that the Chairman of the Government Activities Subcommittee, House Committee on Government Operations, was unable to agree to the sale of the facilities at the price proposed by GSA. The Secretary of the Interior advised the Board members also that he believed that the Corporation could not allow this disposal to be delayed any longer and recommended that he be authorized to sell the facilities to the Government of the Virgin Islands on the same terms as GSA had anticipated selling them.

On May 28, 1965, the Board of Directors authorized the sale of the facilities based on the amount and conditions set forth in the GSA proposal which had previously been questioned by the Chairman, Government Activities Subcommittee. On the same date, the Corporation agreed to transfer the facilities to the Government of the Virgin Islands effective May 31, 1965.

The contract of sale provided for a selling price of $6.5 million as adjusted to reflect changes in plant investment and current assets between September 30, 1964, the appraisal cutoff date, and May 31, 1965, the transfer date. The adjusted price established pursuant to provisions of the contract was $7,296,765 and resulted in a net loss, recorded in the Corporation's accounting records, of $2,861,119. Terms of the sale provided for the insular government to make a down payment of $500,000 and to pay the balance in 19 equal annual payments with interest of 4-1/4 percent payable on the unpaid balance. The amount receivable from the insular government was reduced by $171,350 for Corporation liabilities which were assumed by the insular government.

As a legal basis for the sale of the electric power and salt water distillation facilities, the Corporation cited section 4(f) of the Virgin Islands Corporation Act (48 U.S.C. 1407c(f)) which authorizes the Corporation to acquire and dispose of property when necessary or appropriate to the conduct of authorized activities.

In our report to the Congress dated March 2, 1966 (B-114822), on the examination of the financial statements of the Virgin Islands Corporation for the fiscal year ended June 30, 1965, we stated that, in our opinion, this sale was an unauthorized disposal of corporate assets because section 4(f), which authorizes the Corporation to acquire and dispose of property in the ordinary and

normal course of conducting its business affairs, could not be considered as authority for the Corporation to sell assets when the sale results in the termination of an authorized corporate activity, as was the result in the sale of the electric power and salt water distillation facilities.

The minutes of the April 16, 1966, meeting of the Corporation's Board of Directors included comments that, in view of the Comptroller General's opinion, the Government of the Virgin Islands could not successfully sell revenue bonds. The Governor of the Virgin Islands, who is a member of the Corporation's Board of Directors, advised the Board that the Government of the Virgin Islands must be in a position to market revenue bonds to expand the system to the full extent required. Therefore, the Board authorized its Chairman, with the concurrence of the Governor, to take such steps as might be necessary to accomplish the sale of the water and power facilities to the Government of the Virgin Islands.

After the Governor had renegotiated with GSA and submitted a revised offer to purchase the electric power and salt water distillation facilities for $9.5 million, the Acting President of the Corporation on July 27, 1966, requested that GSA resume its efforts to dispose of the facilities to the Government of the Virgin Islands under the provisions of the Federal Property and Administrative Services Act of 1949, as amended.

On August 4, 1966, GSA submitted revised statements to the Senate and House Committees on Government Operations, in which it proposed that the facilities be sold to the Government of the Virgin Islands for $9.5 million, or about $2.2 million more than the amount previously agreed upon for the sale of the facilities.

On December 30, 1966, the Government of the Virgin Islands clarified its proposal to GSA by submitting a revised offer to purchase the facilities, and on January 26, 1967, GSA accepted the offer of $9.5 million.

The principal officials responsible for the sale of the federally owned electric power and salt water distillation facilities to the Government of the Virgin Islands are listed in appendix I of this report.

FINDINGS AND RECOMMENDATION

REVIEW OF LEGAL BASIS FOR SALE OF ELECTRIC POWER AND SALT WATER DISTILLATION FACILITIES

On May 28, 1965, the Virgin Islands Corporation entered into an agreement for the sale of its electric power and salt water distillation facilities to the Government of the Virgin Islands, citing as its authority section 4(f) of the Virgin Islands Corporation Act (48 U.S.C. 1407c(f)).

Subsequently, in our report to the Congress dated March 2, 1966, on the examination of the financial statements of the Virgin Islands Corporation for the fiscal year ended June 30, 1965, we stated that, in our opinion, this sale was an unauthorized disposal of corporate assets because section 4(f), which authorizes the Corporation to acquire and dispose of property in the ordinary and normal course of conducting its business affairs, could not be considered as authority for the Corporation to sell assets when the sale results in the termination of an authorized corporate activity, as was the result in the sale of the electric power and salt water distillation facilities.

The Virgin Islands Corporation--which succeeded the Virgin Islands Company--was created pursuant to the Virgin Islands Corporation Act, approved June 30, 1949, to promote the general welfare of the inhabitants of the Virgin Islands through the economic development of the Islands. According to this act, the Corporation was to have succession until June 30, 1959, unless sooner dissolved by an act of the Congress; however, the Congress subsequently extended the termination date of the Corporation's charter to June 30, 1969.

Section 4(f) of the Virgin Islands Corporation Act provides as follows:

"(f) To acquire, in any lawful manner, any property--real, personal, or mixed, tangible or intangible--to hold, maintain, use, and operate the same; and to sell, lease, or otherwise dispose of the same, whenever any of the foregoing transactions are deemed necessary or appropriate to the conduct of the activities authorized by this Act, and on such terms as may be prescribed by the Corporation."

This provision authorized the Corporation to acquire and dispose of property in the ordinary and normal course of conducting its business affairs so that it could operate and engage in the various authorized activities during the life of the Corporation.

Since the Corporation initially was to have succession for 10 years, unless sooner dissolved by an act of the Congress, and was to continue and expand upon the work and activities of its predecessor, the Virgin Islands Company, it does not appear that the Congress intended the disposal provisions in section 4(f) of the act to be considered as authority for the Corporation to sell its assets when the sale would result in the termination of an authorized corporate activity.

Prior to 1958, the Corporation sold several of its assets; however, it sold them in accordance with the provisions of the Federal Property and Administrative Services Act of 1949, as amended.

The Administrator of General Services, on September 25, 1953, approved the sale of some 800 acres of the Corporation's agricultural lands on the Island of St. Croix to local inhabitants. The disposal of Bluebeard's Castle Hotel, an asset of the Corporation located on the Island of St. Thomas, was approved by the Administrator on November 16, 1953, and the sale was consummated on June 23, 1954. Similarly, the sale of a Corporation-owned rum distillery to a private corporation was approved by the Administrator on December 11, 1953.

Regarding the sale of the agricultural lands and the rum distillery, explanatory statements on the proposed negotiated sales were submitted to the Senate and House Committees on Government Operations in compliance with section 203(e)(6) of the Federal Property and Administrative Services Act of 1949, as amended (40 U.S.C. 484(e)(6)), and no objections were received.

Section 1 of the act of September 2, 1958 (72 Stat. 1759), amended section 4(a) of the Virgin Islands Corporation Act (48 U.S.C. 1407c(a)), and contained specific provisions regarding the disposal of the Corporation's assets. The amendment to section 4(a) provides, in pertinent part, as follows:

> "At such time as the Board of Directors finds that the economic development of the Virgin Islands of the United States will be served effectively by the sale of some or all of the assets of the Corporation to private enterprise, such disposal may be effected, and for this purpose the Board of Directors is authorized to sell any or all such assets at such time as it considers appropriate for a fair and reasonable value, without regard to the provisions of the Federal Property and Administrative Services Act of 1949, as amended, or any other law: Provided, That the sale of any property valued at $500 or more shall be made only after public advertisement and by sealed competitive bids or public auction: Provided further, That in either such case the Government of the Virgin Islands shall have the right to purchase the property at a price not greater than that offered by the highest responsible bidder and that, in the case of sales of property valued at less than $500, it shall have a right to purchase at a price not greater than that offered by responsible prospective purchasers."

The legislative history of the above-quoted amendment shows that during the first session of the Eighty-fifth Congress a number of identical bills (H.R.s 5643, 5680, 5683, and 5688) were introduced to amend section 4(a) of the Virgin Islands Corporation Act

for the purpose of extending the charter of the Corporation to June 30, 1969, but none of the bills provided specific authority for disposal of the Corporation's assets.

The views of the Department of the Interior were requested on those bills, and, in a letter dated March 27, 1958, to the Chairman, House Committee on Interior and Insular Affairs, the Under Secretary of the Interior recommended that any one of the bills be enacted. However, he recommended also the adoption of certain amendments to the Virgin Islands Corporation Act and enclosed a proposed substitute bill incorporating such amendments. The first amendment proposed in the draft of legislation submitted by the Department of the Interior concerned the authority for the disposal of the Corporation's assets.

Regarding the proposal to authorize the disposal of the Corporation's assets, the Under Secretary stated, in pertinent part, in his letter of March 27, 1958, as follows:

> "Our first amendment would authorize the disposal of the Corporation's assets, in the event that such disposal might prove feasible and opportune. When the Federal Government originally undertook operation of the various activities, it was solely for the purpose of providing a source of employment and income for the people of St. Croix. It is not regarded as a desirable field of permanent Federal activity, if the need met by VICORP [Virgin Islands Corporation] can be met with equal effectiveness by private enterprise. During the long period of annual losses, there was obviously no possibility of disposing of the property in a manner that would protect the investment of the Federal Government, but the recent success in bringing the Corporation into profitable operation has given rise to the hope that an advantageous disposal might be possible. While we know of no potential purchaser or purchasers at this time, it is considered desirable to provide authority for such disposal

of part or all of the assets, in the event an opportunity of taking such action should arise.

"The language proposed in section 1 of the attached bill with respect to disposal of the Corporation's assets has been drafted in recognition of the facts that (1) disposal of all the assets of VICORP may not be either feasible or desirable immediately; (2) such disposal could probably be effected only as a result of prolonged negotiation with potential buyers, and by selling groups of assets of the Corporation on a 'going-concern' basis; and (3) even in the event all the revenue-producing assets of the Corporation were disposed of, appropriate provision would have to be made for the continued performance of certain of the Corporation's present functions."

The provision in the substitute draft concerning the disposal of the Corporation's assets was incorporated in House bill 12226 (85th Cong., 2d sess.) as a further amendment to section 4(a) of the Virgin Islands Corporation Act. In House Report 1841 on House bill 12226, with reference to the proposed amendment to section 4(a), it was stated on page 4 as follows:

"*** Section 1 also authorizes the Board of Directors to dispose of the Corporation's assets if, in their opinion, such disposal is feasible and opportune. The committee members do not believe that it is desirable to continue operation of the Corporation as a permanent Federal activity if a private enterprise can be found to take over operations. While no potential purchaser is known, it is considered desirable to provide authority for disposal of part or all of the assets, if an opportunity arises. ***"

The Senate Committee on Interior and Insular Affairs added two provisos to the Department's proposed amendment to section 4(a) of the Virgin Islands Corporation Act requiring that the Corporation's assets be sold at public auction and granting the Government of the

Virgin Islands the right to purchase such assets at no more than the highest responsible bid. In Senate Report 2261 on House bill 12226, it was stated on page 3, with reference to the proposed amendment, including the two provisos, to section 4(a), as follows:

> "*** Section 1 also authorizes the Board of Directors to dispose of the Corporation's assets if, in their opinion, such disposal is feasible and opportune. The committee adopted an amendment to this section to require that all sales of corporation assets be made at public auction. This would insure public notice of such sales and would allow the corporation to give notice of minimum acceptable prices and other appropriate terms and conditions of sale. The amendment would grant to the government of the Virgin Islands the right to purchase such assets at no more than the highest responsible bid. The language would not require a sale to the Virgin Islands government if no responsive bid was equal to or in excess of the minimum acceptable price. The amendment is intended to give the Virgin Islands government a right of first refusal after an acceptable bid has been made by an intending purchaser."

On page 2 of the conference report on House bill 12226, House Report 2701, regarding the proposed amendment to section 4(a), the managers for the House stated:

> "The principal question at issue in connection with the Senate amendments to H.R. 12226 was the method of sale of assets of the Virgin Islands Corporation. The House language had left discretion to the Directors of the Corporation to use negotiated sales, competitive bidding, or public auction as they saw fit. This was recommended by spokesmen for the Department of the Interior in the belief that negotiated sales frequently produce a better bargain for the Government than competitive bidding or public auction does. The Senate amendment required a public auction in all cases. Agreement was reached by the conferees that sales of assets valued at $500 or more shall be by public auction or competitive bidding and that sales of assets valued at less than that

> amount may be by such method as the judgment of the Directors dictates. In either case, 'fair and reasonable value' must be realized and, as provided by the Senate amendment, the Virgin Islands government will have a first refusal."

It seems clear from the foregoing that the Department of the Interior and the Congress considered it necessary to provide the Corporation with specific authority to dispose of its assets when such disposal would result in the termination of an authorized corporate activity that was being conducted to promote the economic welfare of the Virgin Islands. There would have been no necessity for the Department to request such authority if it had been of the opinion that the Corporation could terminate the operation of its activities by disposing of its assets pursuant to section 4(f) of the Virgin Islands Corporation Act.

Also, in view of the careful consideration given by the Congress to the matter of providing the requested authority, it is apparent that the Congress did not regard section 4(f) as authority for the Corporation to dispose of assets and to thereby terminate the operation of activities which were to be promoted, encouraged, and expanded by the Corporation.

Therefore, we concluded that section 4(f) gave the Corporation the authority to dispose of property in the operation and conduct of its authorized activities, whereas section 4(a) gave the Corporation the authority to dispose of its assets when such disposal would result in termination of the operation of an authorized corporate activity. Since the sale by the Corporation of its electric power and salt water distillation facilities resulted in the termination of an authorized corporate activity, the Corporation did not

have authority to dispose of such assets on the basis of section 4(f) of the Virgin Islands Corporation Act.

Virgin Islands Corporation and Department of the Interior comments and our conclusion

In commenting on matters discussed in this report, the Acting President of the Corporation, as spokesman for the Corporation and the Department of the Interior, advised us that, although the matter was arguable, they remained satisfied that the use of section 4(f) of the Virgin Islands Corporation Act as the authority for the sale in May 1965 of the electric power and salt water distillation facilities was as valid as the Corporation's use of section 4(f) in the sale of its sugar mill and sugar lands in June 1964.

The Acting President cited the 1964 sale of the sugar properties to show that the Corporation had merely continued to use section 4(f) as its authority for the 1965 sale of the electric power and salt water distillation facilities and that it did not regard the use of section 4(f) in the latter sale as a strained and dubious exercise to circumvent the proper jurisdiction of the Congress.

At a meeting of the Corporation's Board of Directors on June 22, 1964, it was clearly disclosed that the Board intended to dispose of the Corporation's sugar mill and sugar lands in accordance with section 4(f) of the Virgin Islands Corporation Act. It was also clear that the disposal of the sugar mill and the major portion of the lands used by the Corporation in the growing of sugarcane resulted in the termination of an authorized corporate activity.

We became aware of these facts while performing our audit of the Corporation's fiscal year 1964 financial statements; however,

we did not question the propriety of this disposal because, in our opinion, the disposal met all of the requirements of a sale under section 4(a) of the Virgin Islands Corporation Act, as amended.

Section 4(a) requires that, in property disposals, the Board of Directors determine that the economic development of the Virgin Islands will be served effectively by the sale of the property to private enterprise and that the Board sell any property valued at $500 or more only after public advertisement and by sealed competitive bids or public auction. The sale of the Corporation's sugar mill and the major portion of its land used for growing sugarcane was made in accordance with these requirements.

In view of the reconveyance of the electric power and salt water distillation facilities to the Government of the Virgin Islands in accordance with provisions of the Federal Property and Administrative Services Act of 1949, as amended, we believe that the sale now has proper legal authority.

REVIEW OF APPRAISED FAIR MARKET VALUE AT WHICH SALE OF ELECTRIC POWER AND SALT WATER DISTILLATION FACILITIES INITIALLY PROPOSED BY GSA

On the basis of our examination into the appraisal firm's determination of the estimated fair market value which was used as the price at which GSA initially proposed to sell the Virgin Islands Corporation's electric power and salt water distillation facilities to the Government of the Virgin Islands, we believe that GSA did not adequately review the private engineering firm's appraisal report on which the selling price was based.

In our opinion, (1) the appraisal firm's deduction of $3.5 million for economic obsolescence under the cost approach was not adequately developed or justified in the appraisal report, (2) the estimated fair market value submitted by the appraisal firm was based on an estimate of future operating income which was inadequately supported, (3) the return of the Federal Government's investment in the salt water distillation facilities, which was ensured under provisions of an assignable contract whereby water produced by the facilities was to be sold to the Government of the Virgin Islands, was not appropriately considered by the appraisal firm, and (4) appropriate consideration was not given to other pertinent factors relating to the marketability of the facilities.

GSA entered into a contract with a private engineering firm to appraise the electric power and salt water distillation facilities declared excess by the Corporation. The contract stipulated that the firm prepare a report on its appraisal of the facilities, setting forth its determination of the fair market value of the facilities for use in place. Fair market value was defined in the contract as follows:

> "The highest price estimated in terms of money which the property will bring if exposed for sale in the open market by a seller who is willing but not obliged to sell, allowing a reasonable time to find a buyer who is willing but not obliged to buy, both parties having full knowledge of all the uses to which it is adapted and for which it is capable of being used."

The contract provided that the firm submit value estimates based on the cost approach, the comparative market approach, and the income approach and that it interpret these different value estimates and state its reasons why one or more of the conclusions reached with respect to the three value estimates would be indicative of the fair market value of the property.

The contract provided also that the value estimate by the cost approach be in schedule form and begin with reproduction or replacement cost and that the dollar amounts for physical deterioration and functional and economic obsolescence, or the omission of the same, be explained in narrative form. The value estimate by the income approach was to include detailed support for gross income, credits, expenses, and capitalization rate. The value estimate by the comparative market approach was to have all comparable sales used confirmed by the buyer, seller, broker, or other person having knowledge of the price, terms, and conditions of sale.

In its report, the appraisal firm stated that, after it deducted from the estimated cost of reproducing the facilities about $10.6 million for physical deterioration and technical, functional, and economic obsolescence, its value estimate under the cost approach was about $7.2 million. The appraisal firm was of the opinion that, in the absence of factual data on the sale of similar electric utilities, the comparative market approach to value estimates was not applicable to the facilities except for the land.

In its interpretation and correlation of estimates, the appraisal firm stated that, under the income approach, it had developed an indicated value of around $9 million. This estimate was based on a capitalization of the facilities' average income for fiscal years 1963 and 1964 before deducting interest expense. The firm stated its belief, however, that the income approach in this situation would not provide the soundest measure of fair market value of the facilities for use in place because of a lack of sound earnings in past years and a questionable prospect for the future under the contemplated ownership and operation of the newly created Virgin Islands Water and Power Authority of the Virgin Islands Government.

In its conclusion on the estimated fair market value of the facilities, the appraisal firm did not utilize the valuations derived under either the cost approach or the income approach. The firm stated its belief that a prospective purchaser would have to recognize the hazards, responsibilities, and unusually heavy financial demands which he would assume immediately upon acquisition of the property. The firm stated that, on the basis of its investigations, operation of the properties should produce a sound operating income of $400,000 to $450,000 a year.

The appraisal firm also stated its belief that, because of the character of the operation, the owner should be entitled to a return on investment of 6.5 percent and that the fair market value of the facilities for use in place, as of September 30, 1964, was $6.5 million. The operating income used by the appraisal firm in arriving at this estimate was significantly less than the actual operating income realized during fiscal year 1964.

In accordance with the requirement of section 203(e) of the Federal Property and Administrative Services Act of 1949, as

amended, GSA submitted statements on January 8, 1965, to the Senate and House Committees on Government Operations, in which it proposed that the Virgin Islands Corporation's electric power and salt water distillation facilities be sold to the Government of the Virgin Islands for $6.5 million.

The appraisal report and its addendum prepared by the private engineering firm was reviewed by GSA's New York regional office appraisal staff and Washington central office appraisal staff. We were advised by members of GSA's Washington central office appraisal staff that appraisal reports are reviewed to determine whether (1) the contract has been complied with by the appraiser, (2) the appraisal techniques and procedures are reasonable, (3) the computations are accurate, and (4) the appraiser's suitability for future GSA assignments has been demonstrated by the quality of the appraisal.

We were also advised that, if the review discloses significant deviations from acceptable appraisal techniques, omissions of necessary information, or significant computation errors, the appraiser may be required to provide additional information or to do additional work. We were further advised that valuations included in an appraisal report represent the judgment of the appraiser and that, although GSA staff reviewers may point out errors or deviations in the report which, in their opinion, should be changed by the appraiser, the appraised fair market value of the property still represents the appraiser's judgment.

In our opinion, obtaining an appraisal of the facilities by a private engineering firm did not absolve GSA of its responsibility under the Federal Property and Administrative Services Act of 1949, as amended, to recover the estimated fair market value of all property sold to territories.

At the time of our review, GSA had a one-price policy whereby surplus Federal property could be sold to public agencies, including local governmental subdivisions (such as the Government of the Virgin Islands), at its estimated fair market value. The estimated fair market value assigned to the property was to be based on a GSA-approved appraisal of the property or on better evidence of its value.

On August 30, 1966, GSA instructed all of its regional administrators that use of the one-price policy should be discontinued and that the sales price for property to be sold to local governmental subdivisions should be negotiated vigorously. The instructions stated that, in the absence of competitive bidding, vigorous negotiation with an intended purchaser to arrive at a sales price should afford the closest approximation to a market test obtainable under the circumstances and would serve to supplement the appraisal in establishing the estimated fair market value of the property.

The following sections describe those matters which we believe would have been disclosed if GSA had performed an adequate review of the private engineering firm's determination of the estimated fair market value of the facilities.

Deduction to compensate purchaser for expansion of facilities inadequately developed or justified

In estimating the value by the cost approach, the appraisal firm allowed a deduction of $3.5 million to compensate the purchaser for the presumed existing deficiency in the capability of the facilities to supply adequate service to meet present and near future demands of the territory to be served. This deduction, comprising $2.5 million for the electric power facilities and $1 million for the salt water distillation facilities, was defined by the appraisal firm as economic obsolescence.

In our opinion, a major portion of the $2.5 million deduction applicable to the electric power facilities was not justified because it reduced the reproduction cost of the existing facilities to allow for the expansion of the facilities to meet future increases in demand but did not allow for recognition of the additional income that would be provided by the expanded facilities.

In addition, at September 30, 1964 (effective date of the appraisal), the St. Croix plant had adequate generating capacity to meet the island's electric power demands, plus a reserve for expansion, and the St. Thomas plant had generating capacity sufficient to meet the electric power demands of the territory it served through that date.

We believe also that the $1 million deduction applicable to the salt water distillation facilities was not proper because it did not include appropriate consideration of the value of the contract for sale of water produced by the facilities which provided for the repayment of the total Federal investment in the salt water distillation facilities. The adverse effect which the $1 million deduction applicable to the distillation facilities would have on

the Federal Government's right under the contract to recover its investment is discussed on pages 38 to 44.

The following tabulation shows how the appraisal firm arrived at its estimate of the facilities' fair market value for use in place under the cost approach. Although a major portion of the appraisal report was devoted to the deriving of valuations under the cost approach, the firm, in its conclusion on the estimated fair market value of the facilities, did not utilize the valuations derived under the cost approach. The analysis of the allocation of the economic obsolescence deduction between the electric power generation and distribution facilities is based on information furnished by the appraisal firm, at the request of GSA, subsequent to the issuance of its appraisal report.

	St. Thomas	St. Croix	Total
Total reproduction cost	$11,416,926	$6,393,988	$17,810,914
Less deductions:			
Economic obsolescence:			
Distillation facilities	1,000,000	-	1,000,000
Generation facilities	1,200,000	800,000	2,000,000
Distribution facilities	300,000	200,000	500,000
Total economic obsolescence	2,500,000	1,000,000	3,500,000
Physical deterioration and technical and functional obsolescence	4,735,320	2,355,850	7,091,170
Total deductions	7,235,320	3,355,850	10,591,170
Appraiser's estimated fair market value under the cost approach	$ 4,181,606	$3,038,138	$ 7,219,744

During our various discussions with representatives of the appraisal firm and of GSA, we did not raise any questions concerning the deductions totaling $7,091,170 for physical deterioration and technical and functional obsolescence (with the exception of those deductions relating to the distillation facilities discussed on pp. 38 to 44) which were set forth separately in the appraisal report for each major asset or group of assets. However, because information for the $3.5 million deduction for economic obsolescence was provided by the appraisal firm in the above broad categories for the distillation, generation, and distribution facilities, rather than identified with specific units of property, which did not provide an adequate basis for determining whether the deduction was justified, we sought to obtain from the firm and GSA the basis for the deduction.

The major portion of the $2.5 million economic obsolescence deduction applicable to the generation and distribution facilities on St. Thomas and St. Croix did not represent an allowance for deficiencies in the system existing at the time of the appraisal but represented a reduction in the value of the Federal Government's investment as a means of compensating a private purchaser for subsequent expansion of the facilities to meet future increases in electric power demands.

We believe that any deduction to allow for expansion of the facilities to meet future increases in demand would not have been equitable to the Federal Government because the expanded facilities should be expected to produce increased electric power sales and revenues to the private purchaser.

The following tabulation shows pertinent data, developed from records of the Virgin Islands Corporation, on the generating capacity of the St. Thomas and St. Croix power plants as of September 30, 1964.

	St. Thomas	St. Croix
	(kilowatts)	
Generating capacity of facilities	11,800	9,242
Less reserve equal to capacity of largest generator on each island	3,000	2,400
	8,800	6,842
Less peak electric power demand experienced by the St. Thomas and St. Croix plants during February and May 1964, respectively	9,000	5,400
Generating capacity in excess of or less than (—) reserve requirements	—200	1,442

The above tabulation shows that the St. Thomas and St. Croix power plants had generating capacity sufficient to meet the peak electric power demands which had been experienced. However, it should be noted that the St. Thomas plant had a 200-kilowatt deficiency in its reserve generating capacity and, if the largest generating unit on St. Thomas had been out of service when the electric power demand reached its peak of 9,000 kilowatts, the St. Thomas power division might have been forced to discontinue providing electric power to consumers in selected geographical areas until the demand decreased to the firm capacity of the plant.

On the basis of the above analysis of the facilities' generating capacity and the peak electric power demands experienced, we believe that the $0.8 million economic obsolescence deduction applicable to the generating facilities of the St. Croix plant was unwarranted and that the $1.2 million economic obsolescence deduction applicable to the St. Thomas generating facilities was excessive because the indicated deficiency in reserve generating

capacity would not, in our opinion, require an investment of $1.2 million to correct.

With respect to the investment needed to correct the 200-killowatt reserve deficiency in the St. Thomas plant, it should be noted that the Corporation purchased for about $500,000 and installed in its St. Croix plant during September 1964 a diesel generating unit with a capacity of 2,400 kilowatts.

Although we believe that a major portion of the $1.2 million deduction applicable to the St. Thomas generating facilities was excessive, we cannot determine the amount because the appraisal firm's working papers do not contain any detailed information as to the portion of the economic obsolescence deduction assignable to compensate the purchaser for the 200-kilowatt reserve deficiency in the existing facilities. The appraisal firm advised us that the deduction was based on engineering judgement and did not identify the major assets or groups of assets to which the economic obsolescence deduction was applicable.

The $0.5 million deduction for economic obsolescence of the transmission and distribution facilities does not appear to have been justified inasmuch as the appraisal firm also deducted over $1 million applicable to the transmission and distribution facilities in its computations for functional and technical obsolescence because of "design and reconstruction required to provide for near future service demands." Any further deduction as an economic obsolescence allowance to compensate the purchaser for additions and improvements beyond those required for near future service demands was, in our opinion, unwarranted.

The sale of the electric power facilities at a price giving consideration to a reduction in the value of the Federal Government's investment as a means of compensating a private purchaser

for subsequent expansion costs could have resulted in the Federal Government, in effect, financing expansion of the facilities, which is contrary to actions taken by the Congress in recent years in refusing to provide Federal funds for such expansion.

In commenting on the Supplemental Appropriation Bill, 1963, in which funds were requested for expansion of the electric power facilities in the Virgin Islands, the Committee on Appropriations, United States Senate, included the following statement in Senate Report 155, dated April 24, 1963.

> "The committee recommends that no funds be appropriated *** for the purpose of expanding the power facilities of the Virgin Islands. This identical request was denied by the committee and the Congress in 1961 (supplemental appropriation bill, 1962), with the admonition that this was a matter which should be presented in a regular annual appropriation bill and that the Department should explore the possibility of interesting private industry in the power installations. In 1962 in the regular annual appropriation bill for fiscal year 1963, the request was again denied."

By letter dated February 25, 1966, GSA advised us that the deduction of $2.5 million for economic obsolescence of the electric power facilities was not intended to compensate a purchaser for costs of expansion of the facilities. Instead, GSA contended, it reflected the estimated amount considered necessary to provide a reasonably firm capacity for the present load; accordingly, GSA could not concur with the view that additional income would be generated by the replacement of existing facilities through the future expenditure of an amount equal to the deduction.

We do not agree with GSA's position that the $2.5 million was needed to provide a reasonably firm capacity for the existing load at the time of the appraisal. Our analysis set forth on page 26

of this report shows that the St. Thomas and St. Croix power plants had adequate generating capacity to meet the peak electric power demands which had been experienced up to the time of the appraisal and, except for 200 kilowatts in the St. Thomas plant generating capacity, had sufficient reserve generating capacity to meet the peak consumer power requirements anticipated at that time.

Accordingly, to the extent that the deduction allowed exceeded the amount needed to compensate for the 200-kilowatt deficiency in the St. Thomas plant reserve generating capacity, we believe that the deduction was not justified and would compensate a purchaser for the cost of expanding existing facilities to meet future increases in consumer demands, increases which would provide corresponding increases in income.

Estimate of future operating income inadequately supported

The estimated fair market value of $6.5 million reported by the appraisal firm on September 30, 1964, was based on engineering judgment as to the amount of income that should be produced by operation of the facilities. GSA accepted the firm's estimate--which was based on an estimated annual operating income of $400,000 to $450,000 capitalized to provide a 6.5 percent return on investment--without requiring it to submit any supporting data in justification of the income estimate.

We believe that, in the absence of such data, GSA could not make an adequate review or evaluation of the reasonableness of the appraisal firm's estimate. Also, in view of the substantial increase in income realized from operation of the facilities in recent years and the fact that the fiscal year 1964 income was substantially greater than the firm's estimate, we believe that it was unreasonable for GSA to accept the estimate without requiring supporting data.

In setting forth the development of its conclusion that the fair market value of the facilities was $6.5 million, the appraisal firm stated that, from the standpoint of the prospective purchaser of the property and business, whether it be the Government of the Virgin Islands or any other type of purchaser, there were factors not evaluated elsewhere in its report that deserved serious consideration. The following factors were listed by the appraisal firm in the September 30, 1964, appraisal.

> "The hazards and responsibility of keeping the properties operating and furnishing adequate service and at the same time finding ways and means of obtaining the necessary funds required for the immediate and near-future plant expansion needed to meet the rapid rate of increase in demand being experienced in the islands.

"The immediate establishment of adequate and competent administrative and operating staffs.

"The necessity of a complete engineering study to effect improvements in present operations and develop adequate plans for the anticipated future requirements.

"The development of realistic Capital and Operating Budgets.

"The requirement for a Feasibility Study and Rate studies in order to assure that the revenue to be obtained will be sufficient to provide for all operating expenses, reserve requirements and have sufficient margin to satisfactorily cover all amortization of Bond principal and interest."

In completing its determination of the facilities' fair market value, the appraisal firm stated that:

"In conclusion, and after careful consideration of all the data developed in the course of our original and recent investigations of the subject property, its operation and the territory served, it is our belief that a prospective purchaser will have to recognize the hazards, responsibilities, and unusually heavy financial demands which he will assume immediately upon acquisition of the property as presently constituted. With this in mind, the results of our investigation indicate to us that as of September 30, 1964, the operation of the subject properties should be able to produce a sound Operating Income of around $400,000 to $450,000 a year. We also believe that due to the character of this operation the owner should be entitled to a return on investment of 6.5 per cent. On this basis, it is our opinion that the Fair Market Value for use in place, as of September 30, 1964, is $6,500,000."

The firm advised us that there were no detailed supporting data evidencing the rationale supporting its conclusion that the facilities would produce a sound operating income of $400,000 to $450,000 a year and that its estimate of operating income had been

based on engineering judgment as to the amount of sound operating income that the system would produce after the economic obsolescence and other factors (listed on pp. 30 and 31 of this report) were corrected. In our opinion, the appraisal firm, in presenting its estimate of operating income, should have been required to present adequate supporting data to provide GSA with a basis for evaluating the reasonableness of the estimate.

Further, the contract between GSA and the appraisal firm provided that the value estimate by the income approach be arranged in detailed form to show at least the estimated gross economic rent or income, the allowance for vacancy and credit losses, and an itemized estimate of total expenses including reserves for replacement. The contract provided also that the capitalization of net income be at the prevailing rate for the type of property and location and that the capitalization technique, method, and rate used be explained in narrative form supported by a statement of sources of rates and factors.

Although, as explained in the following paragraphs, the appraisal firm did not use a valuation developed under the income approach--one approach required by the provisions of the contract--the firm, in arriving at its conclusion as to the facilities' estimated fair market value, used a method similar to the income approach. Accordingly, we believe that the appraisal firm should have been required to follow the contract guidelines in presenting supporting information for its estimate. In view of the lack of detailed support, we have assumed that the estimated operating income shown includes deductible interest expense because the appraisal firm used an operating income which included deductible interest expense in its computation of the estimated value of $9 million under the income approach.

Under the income approach in the September 1964 addendum, the appraisal firm capitalized at 6 percent the average operating income before deducting interest expense realized by the Corporation from operation of the electric power and salt water distillation facilities during fiscal years 1963 and 1964, which resulted in a value of about $9 million. However, the firm stated its belief that the earnings history and future prospects could not be accepted as a sound measure of the subject property's fair market value for use in place.

In setting forth the development of this conclusion, the appraisal firm stated that it doubted that the amounts for operating and maintenance costs were truly indicative of the actual requirements of the operation. For example, the firm stated the operation was understaffed in all departments and a considerable amount of required maintenance reportedly had been deferred on both islands. In addition, the firm stated that a brief analysis of existing records had disclosed that numerous items, which were obviously expense, had been charged to capital accounts.

Although we have not evaluated the adequacy of the staffing of the electric power and salt water distillation operations, we noted that, during the 11-month period ended May 31, 1965, the Corporation, which the appraisal firm stated was understaffed in all departments, provided electrical services for 1,048 additional consumers. Also, it should be noted that, during our audits of the Corporation, we made an extensive analysis of expense and capital (fixed asset) accounts and found no significant errors of classification.

Regarding the appraisal firm's statement, in the addendum report dated September 30, 1964, that it had been informed that a considerable amount of maintenance had been deferred on both

islands, it should be noted that the firm stated in its original appraisal report, dated March 20, 1964, that the generators on both islands had been maintained in good operating condition. In addition, a consulting engineering firm employed by the Government of the Virgin Islands had prepared an appraisal report dated August 31, 1964, on the Corporation's electric power and salt water distillation facilities, which contained the following statement with regard to the distribution facilities.

> "Detailed field inspections of the distribution facilities were not made. However, a careful check of wire and transformer sizes in relation to present loads has been completed. In visits to the Islands, the condition of the system in Charlotte Amalie and in a part of St. Croix has been observed.
>
> "The facilities which were observed indicated excellent construction methods and good maintenance. Experience indicates that if there is poor or careless work on any distribution system, it is evident in the details of all parts of the system. No such condition was observed in the areas inspected.
>
> "From this observation, and from checks of wire and equipment sizes, we conclude that the distribution system is capable of taking care of loads for the present and for the immediate future. ***" (Underscoring supplied.)

Although the appraisal firm employed by GSA, in arriving at its conclusions of the facilities' fair market value, questioned whether the Corporation's past earnings history and future prospects could be accepted as a measure of fair market value, our analysis of the Corporation's operations since September 1961--when the present power rate schedules were placed in effect--disclosed a substantial rate of growth in both electric energy sold and operating income.

A comparison of current operating income with operating income prior to fiscal year 1962 does not appear to be a good indication of the growth of the electric power system because the earlier power rates were too low, as evidenced by a rate increase in September 1961, and because significant deficiencies, which we commented on in our report to the Congress dated April 16, 1962 (B-114822), on the audit of the Virgin Islands Corporation, existed in meter-reading and customer-billing procedures. Except for considering growth potential, operating income prior to fiscal year 1964 does not appear to be representative of the income capability of the system since sales are increasing significantly each year.

The following summary for fiscal years 1962, 1963, and 1964 and for the 11-month period ended May 31, 1965, shows the kilowatt-hours sold and the operating income from the electric power and salt water distillation facilities.

Fiscal year	Kilowatt-hours sold (thousands)	Operating income before deducting interest expense		
		Electric power	Salt water distillation	Total
1962	39,748	$304,648	$10,775	$315,423
1963	48,514	352,068	52,669	404,737
1964	58,957	678,105	47,804	725,909
1965	61,441	860,881	44,011	904,892

Further, the hazards, responsibilities, heavy financial demands, and other factors listed by the appraisal firm as matters which the prospective purchaser would have to assume upon acquisition of the property are, in our opinion, problems that would be assumed and solved by any company providing electric utility services to a community with an expanding economy, such as the Virgin Islands, and should not be considered as reducing the value of the existing facilities. In addition, we believe that these factors do

not adequately support or justify the estimate of a sound operating income of $400,000 to $450,000 a year in view of the fact that the operating income realized by the Corporation from operation of the electric power and salt water distillation facilities was about $726,000 during fiscal year 1964 and about $905,000 for the first 11 months of fiscal year 1965.

By letter dated February 25, 1966, GSA advised us that it considered the estimate of operating income to be adequately supported and, if anything, weighted in favor of the seller, not the purchaser. GSA stated that, under normal procedures operating income and expenses over a period of time in the past and income forecast for the future would be used to establish value based on the earnings approach and that the earnings approach used had been based solely on the net earnings of the past year and did not consider the lower earnings of previous years.

GSA also advised us that modern power production machinery and equipment was far superior to most of that used in the Virgin Islands and therefore it believed that the future cost of maintenance and operations would hold down the net earnings of the facilities.

Our review of the appraisal report prepared by the private engineering firm for GSA and our discussions with officials of the firm indicate that the estimate of the facilities' fair market value was based on the firm's judgment as to the amount of operating income that the facilities should produce (see extract from appraisal report on p. 31) rather than on the earnings of the past year as indicated by GSA.

Regarding GSA's contention that the future cost of operations would hold down the net earnings of the facilities, it should be noted that the Corporation's operating experience in recent years does not support this view. After the rate increase in September

1961, the income produced by operation of the existing facilities steadily increased from about $315,000 for fiscal year 1962 to about $905,000 for the 11-month period ended May 31, 1965.

In addition, with respect to GSA's comment that modern power production machinery and equipment was far superior to most of that used in the Virgin Islands, it should be noted that the Corporation had made substantial modern additions to the facilities in recent years. For example, about 70 percent of the facilities' total generating capacity consisted of generating units purchased and installed by the Corporation during calendar year 1960 or later.

Value of contract for sale of water produced by distillation facilities not given appropriate consideration

In our opinion, the appraisal firm, in its valuation of the electric power and salt water distillation facilities under the cost approach, did not give appropriate consideration to the value of the contract for sale of water produced by the distillation facilities, whereby the Corporation over a 20-year period was entitled to recover its total investment in the facilities from the Government of the Virgin Islands. The unrecovered portion of the investment in the salt water distillation facilities totaled about $897,000 at the time of the appraisal on September 30, 1964, and about $865,000 at the time of the transfer on May 31, 1965.

The Congress, in its September 2, 1958, amendment of the Virgin Islands Corporation Act, authorized the Corporation to construct, operate, and maintain salt water distillation facilities in St. Thomas, Virgin Islands (48 U.S.C. 1407c(o)). The amendment provided that the Corporation not execute the principal contract for construction of the facilities until the Government of the Virgin Islands contracted to purchase a minimum quantity of water at a price established by the Corporation which would be calculated to cover all costs of construction, operation, and maintenance of such water distillation facilities.

Pursuant to this amendment, the Corporation entered into a contract on January 16, 1959, whereby the Government of the Virgin Islands agreed to purchase a minimum of 36.5 million gallons of water a year for 20 years. In accordance with provisions of the contract, the 20-year period commenced when potable water was produced on a sustained basis during February 1962.

The contract provided for sale of the water at cost, plus a reasonable rate of return on the investment. The term "cost" was defined in the contract as embracing all expenditures of whatsoever kind in connection with, growing out of, or resulting from, work performed in connection with the installation, operation, and maintenance of the water distillation facilities.

The contract also stated that its provisions would be applicable to and binding on the successors and assigns of the respective parties but that no assignment or transfer of the contract or any part thereof or interest therein would be valid unless approved by the Secretary of the Interior.

The salt water distillation plant was installed for integrated operation with a steam-turbine generating unit and a boiler plant. The electric energy generated by the steam-turbine unit is used to run the distillation plant as well as to provide energy for sale to the general public; the boiler plant provides the steam needed to operate the salt water distillation plant and the steam-turbine unit.

The total cost for acquisition and installation of these facilities was about $2,095,000, of which about $1,015,000 was allocated to the salt water distillation facilities and the balance to electric facilities. At the time of the appraisal, the Corporation had recovered about $118,000 of the allocated cost of the salt water distillation facilities through the sale of water to the Government of the Virgin Islands and, under provisions of the contract for sale of water, was entitled to recover the additional $897,000.

Under the cost approach, the appraisal firm in its overall valuation of the electric power and salt water distillation facilities, included deductions which were applicable to the distillation facilities but which were $326,000 in excess of the amount

that it had included as the reproduction cost of the distillation facilities. The excess deduction, together with the $897,000 unamortized cost of the facilities, resulted in an understatement of value totaling $1,223,000. Our analysis of identifiable factors in the appraisal report showed that the firm's valuation of the salt water distillation facilities under the cost approach was as follows:

Reproduction cost as of September 30, 1964:			
Distillation plant			$ 465,000
Pumping station			212,000
Boiler plant		$ 508,000	
Less portion allocated to electric plant		285,000[a]	223,000
Total cost of reproduction			900,000
Deduct:			
Physical deterioration:			
Distillation plant		139,000	
Pumping station		42,000	
Boiler plant	$102,000		
Less portion allocated to electric plant	57,000[a]	45,000	
Total physical deterioration		226,000	
Technical and functional obsolescence		-	
Economic obsolescence		1,000,000	
Total deductions			1,226,000
Estimated deduction in excess of reproduction cost			$ -326,000

[a]The appraisal firm in its report did not allocate the reproduction cost of the boiler plant and its related physical deterioration to the salt water distillation and electric power facilities. Therefore, for the purpose of our analysis, we allocated these amounts on the same basis as the Corporation allocated the original acquisition and installation costs.

In commenting on our letter dated November 10, 1964, the attorney for the Government of the Virgin Islands advised the Department of the Interior that the $1 million Federal investment allocated to the distillation facilities was based on an assumption of 8,400 hours of sustained water production a year or 350 days of use. The attorney also stated that, under provisions of the contract, the Government of the Virgin Islands could limit the purchase of water produced by the distillation facility to 36.5 million gallons a year or 120 days of production, which in effect would reduce the amount of Federal investment allocated to the distillation activities.

Although the Government of the Virgin Islands could limit its water purchases to the minimum specified under the contract, it should be noted that the contract provided also that the cost of water sold to the Government of the Virgin Islands include an amount for amortization of the investment. The cost determination made by the Corporation, pursuant to the contract, was based on the amortization of the total allocated cost of the distillation facilities over the 20-year life of the contract; accordingly, the amount of investment to be amortized would not fluctuate with the volume of water sold.

The appraisal firm, in its comments on our November 10, 1964, letter, stated that the profits derived from the contract for sale of water to the Government of the Virgin Islands were included in its consideration of the income approach.

Under the income approach, the appraisal firm capitalized at 6 percent the average operating income of the electric power and salt water distillation facilities realized by the Corporation during fiscal years 1963 and 1964, which resulted in a valuation of

about $9 million. Of this amount, about $840,000 was applicable to the distillation facilities, which was about $57,000 less than the amount that the Corporation was entitled to recover under the contract.

The firm did not, however, base its estimate of the facilities' fair market value on either the cost approach or the income approach but based the estimate on a capitalization of an amount which, in its judgment, would be the estimated operating income and submitted no detailed supporting data evidencing the rationale supporting its conclusion. Accordingly, we could not determine to what extent income from the salt water distillation facilities was reflected in the appraisal firm's determination of the facilities' fair market value.

GSA, by letter dated February 25, 1966, advised us that it believed adequate consideration had been given to the contract for the sale of water to the Government of the Virgin Islands. GSA stated also that it was not considered appropriate to assign a value to the contract itself but rather to establish the value of the salt water distillation facilities by capitalizing the earnings from those facilities, together with the earnings from the power facilities, and thereby establish the value of the whole.

We believe that the amount of the unrecovered portion of the Federal Government's investment in the salt water distillation facilities should have been clearly indicated in view of the requirement in the authorizing legislation that the Corporation not execute the principal contract for construction of the facilities until the Government of the Virgin Islands contracted to purchase a minimum quantity of water at a price which would be calculated to cover all costs of construction, operation, and maintenance of such water distillation facilities.

The contract, whereby the Government of the Virgin Islands agreed to purchase the water produced by the Corporation's distillation facilities, stated in its preamble that the Corporation was willing to construct and operate water distillation facilities in St. Thomas, contingent upon arrangements which would ensure that the Corporation would neither sustain a financial loss thereby nor subsidize the potable water distribution system of the Virgin Islands Government in St. Thomas.

In the letter dated February 25, 1966, GSA also discussed the Government of the Virgin Islands' contract with a private corporation to install a water desalting plant with a 1-million-gallon-a-day distillation capacity. GSA expressed the opinion that the fact that the new plant reportedly could be expected to produce water at a cost of 90 cents for every 1,000 gallons--which is substantially less than the cost of producing water by the existing plant--was indicative of the uneconomical attributes of the existing distillation plant and lent additional support to the deduction for economic obsolescence.

We do not question that, since the Corporation installed and commenced operation of its distillation plant in February 1962, there have been major technological advances in the design and construction of distillation plants, which, coupled with the economies to be realized from operation of a plant designed for a larger capacity (1 million gallons a day compared with 275,000 gallons a day), may reduce the unit cost of water produced. However, we do question the appraisal firm's deductions for physical deterioration and economic obsolescence, which exceeded the reproduction cost by about $326,000, in view of the Federal Government's right under the contract to recover its entire investment in the salt water distillation facilities.

In view of the explicit provision of the law which authorized construction and operation of the salt water distillation facilities and in view of the assignable contract entered into pursuant to such provision of law, we believe that the unrecovered portion of the Federal Government's investment should have been the minimum valuation assigned to the salt water distillation facilities.

Appropriate consideration not given to other pertinent factors relating to marketability of facilities

In our opinion, appropriate consideration was not given to the interest expressed by several private investment and utility firms in acquiring the facilities although several Department of the Interior and Corporation officials recognized that a private firm might be willing to purchase the facilities for more than the $6.5 million submitted by the appraisal firm as the estimated fair market value. Also, appropriate consideration was not given to the fact that utility systems in the United States generally are sold for an amount at least equal to their net book value.

Although the individual consideration of such factors as expressed interest of private firms, statements of responsible officials, and general practice in sales of utility systems would not necessarily be indicative of the facilities' estimated fair market value, we believe that such factors are indicators of value which should be considered in arriving at the estimated fair market value.

Our view that the Corporation's electric power and salt water distillation facilities were appraised at an amount substantially less than the facilities' fair market value is supported by the fact that the St. Croix Electric Cooperative Association made efforts to purchase the St. Croix portion of the Corporation's facilities. This association was organized to acquire and operate the electric power system on the Island of St. Croix. In this connection, the association had a private firm conduct a study and prepare a report on the economic feasibility of the association acquiring and operating the Corporation's electric power facilities on St. Croix.

The report setting forth the firm's findings and conclusions contained the following statement:

> "If the electric system on the island of St. Croix is acquired from the Virgin Islands Corporation at net book cost, plus materials inventory, it can be owned and operated by a local electric cooperative as a self-sustaining economic enterprise." (Underscoring supplied.)

Although representatives of the association presented, at the March 7, 1964, meeting of the Corporation's Board of Directors, their views on why the association should be allowed to acquire the St. Croix portion of the facilities, the Board of Directors did not take any action on the association's proposal.

In commenting on the sale of the facilities, the Secretary of the Interior stated, in the agenda for the May 28, 1965, Board of Directors' meeting, that the facilities would quite possibly bring in more than $6.5 million if put up for competitive bid. Previously, at the March 5, 1965, meeting of the Corporation's Board of Directors, the Assistant Director, Office of Territories, who is responsible for the Department of the Interior activities in the Virgin Islands, stated that $9.5 million might be obtained if the electric power and salt water distillation facilities were publicly offered to the highest bidder.

Subsequent to the May 28, 1965, Board of Directors' meeting in which the sale of the facilities at $6.5 million was authorized, the Assistant Director, Office of Territories, advised us that the Board of Directors realized that the sale would result in a subsidy to the Government of the Virgin Islands to the extent that net book value of the facilities would not be recovered through the sales price.

Correspondence in the Corporation's files established that in recent years there had been considerable interest expressed by private enterprise in the purchase of the Corporation's electric power and salt water distillation facilities. The marketability of the facilities is exemplified by the following statement contained in a letter dated June 30, 1965, to the Acting President of the Corporation from the Director, Office of Territories, Department of the Interior.

> "*** I believe there has never been any doubt that there would be very great interest shown by private enterprise if the power and water system were sold by public advertisement. We have never attempted to deny that that was so, and have assured all inquirers (such as the Interior and Appropriations Committees, where the question has often arisen), that indeed, many companies have expressed apparently genuine interest. Were the point to be made anew, I feel sure that everyone associated with both Interior and VICORP [Virgin Islands Corporation] would readily state that a disposal to the Virgin Islands Government was effected notwithstanding the virtual certainty that many private enterprises would have liked an opportunity to bid to buy the system."

Moreover, a member of the Virgin Islands Corporation Board of Directors, who opposed the sale of the facilities to the Government of the Virgin Islands, expressed the view at an August 1963 Board meeting and again in a letter dated May 18, 1965, to the Director, Office of Territories, that several private firms were interested in acquiring the property.

Since the Corporation's electric power and salt water distillation facilities were appraised at substantially less than the net acquisition cost of the assets (net book value) and in view of the interest described above, it appears that private enterprise would have acquired the facilities at an amount substantially in excess

of the value at which they were appraised if the facilities had been made available for sale by competitive bid.

In addition, although the sale of electric power in the Virgin Islands is not subject to regulation by the Federal Power Commission, information obtained from the Commission on the sale of 15 utility systems throughout the United States since February 1961 disclosed that the systems were sold for amounts in excess of their net book value. At the time we obtained this information, we were also advised that utility systems are rarely sold for less than net book value.

In its February 25, 1966, letter to us, GSA suggested that few utilities are sold and that, when one is sold, its selling price depends on many considerations other than book value. GSA also stated its belief that further contact with the Federal Power Commission would disclose that public utilities had been sold for less than net book value. In addition, GSA, in commenting on net book value, advised us that accounting determinations, although useful in establishing value, are only one of the considerations used in arriving at a final judgment.

We concur with GSA's views that a utility's selling price depends on many considerations other then book value and that under unusual circumstances utility systems have probably been sold for less than book value. However, because (1) utility systems generally are sold for an amount at least equal to their book value, (2) no detailed support was submitted for the appraisal firm's estimate of operating income under the income approach and for the economic obsolescence deduction under the cost approach, and (3) the market value was not established by competitive bid, we believe that under the circumstances book value was a valid

indication of value of the electric power and salt water distillation facilities and should have been given prominent consideration.

General Services Administration

general comments and our conclusions

In addition to the specific comments concerning the estimated fair market value of the facilities, which are discussed previously in this report, GSA advised us on February 25, 1966, that estimating the value of utility systems is more difficult than estimating values of other less unique real estate interests and that the firm employed by GSA possessed and utilized the necessary engineering talent. GSA advised us also that, in the course of its appraisal review, it had evaluated the reasonableness of deductions for economic obsolescence, the estimate of future operating income, the return of the Federal Government's investment in the salt water distillation facilities, and the estimated fair market value compared with net book value.

GSA stated that it had determined, as a matter of judgment, that the conclusions set forth in the appraisal report were reasonable and that it had considered, among other factors, the experience and professional judgment of the appraisal firm. Accordingly, GSA stated that in its opinion it had discharged its responsibility under the Federal Property and Administrative Services Act of 1949.

As stated previously (see pp. 31 and 32), the appraisal firm advised us that there were no detailed supporting data evidencing the rationale supporting its conclusion that the facilities would produce a sound operating income of $400,000 to $450,000 a year and that its estimate of operating income had been based on engineering judgment as to the amount of sound operating income that the system would produce after the economic obsolescence and other factors listed on pages 30 and 31 were corrected.

We believe that factors other than engineering judgment should be applied in estimating the future sales, expenses, and capital expenditures which are to be used in determining estimated future income from facilities such as those transferred by the Corporation.

In our opinion, GSA should require appraisers to furnish supporting data fully describing the assumptions made and the sources used in arriving at such determinations and explaining the relationship between the projected data and the earnings experienced from the facilities in the past. We believe that, in the absence of such supporting data, an adequate evaluation of the appraisal firm's conclusions could not have been made by GSA.

GSA's Handbook on the Appraisal of Excess and Surplus Real Property requires that each appraisal report contain adequate supporting data and other factual information used in the development of a value estimate in sufficient detail to permit an intelligent review of the appraisal report. The handbook requires that such data be analyzed sufficiently in the report to support the appraiser's valuation conclusion.

The handbook also states that, when a GSA official reviewing an appraisal report believes that an appraiser has failed to support its indicated valuation, he should ask the appraiser to produce additional information to make the appraisal acceptable. The handbook indicates that, when an appraisal is found to have deficiencies which cannot otherwise be resolved, a reappraisal may be obtained.

We believe that, had an adequate evaluation of the appraisal firm's justifications been made in accordance with the principles set forth in the GSA handbook, it would have become apparent to GSA

that there was inadequate support regarding certain aspects of the appraisal and that the appraisal firm should be requested to submit an adequately supported revised estimated fair market value giving appropriate consideration to all pertinent factors relating to the marketability of the facilities.

We believe that, in the absence of obtaining such a revised estimated fair market value, GSA should have either made appropriate adjustments to the fair market value estimate submitted by the appraisal firm or obtained another appraisal of the facilities.

Although, as stated on page 22, GSA procedures have been revised so that an appraiser's estimated fair market value is not necessarily the price at which surplus Federal property is to be sold to public agencies, they do provide GSA with a basis for negotiation. Therefore, we believe that the problems encountered in connection with the disposal of the electric power and salt water distillation facilities emphasize the need for obtaining sufficient supporting data to enable an adequate evaluation to be made of an appraiser's conclusions as to the fair market value of property for disposal by GSA.

Recommendation to the Administrator of General Services

So that estimated fair market values that may be established for surplus Federal properties adequately protect the Federal Government's investment in accordance with the requirements of the Federal Property and Administrative Services Act of 1949, as amended, we recommend that the Administrator of General Services emphasize to the GSA appraisal review staff the need for appraisal reports to contain supporting data which fully describe the factors considered in estimating fair market value, such as economic obsolescence and projected net income, and the basis for arriving at the increase or reduction in value attributable to each factor.

APPENDIXES

PRINCIPAL OFFICIALS

RESPONSIBLE FOR THE SALE OF

FEDERALLY OWNED ELECTRIC POWER AND

SALT WATER DISTILLATION FACILITIES

TO THE GOVERNMENT OF THE VIRGIN ISLANDS

	Tenure of office	
	From	To
VIRGIN ISLANDS CORPORATION:		
Board of Directors:		
Secretary of the Interior:		
Stewart L. Udall (Chairman)	Jan. 1961	Present
Secretary of Agriculture		
Orville L. Freeman	Jan. 1961	Present
Administrator, Small Business Administration:		
Bernard L. Boutin	May 1966	Present
Eugene P. Foley	Aug. 1963	Sept. 1965
Governor of the Virgin Islands:		
Ralph M. Paiewonsky	Apr. 1961	Present
Businessmen:		
Ward M. Canaday	June 1949	June 1965
Robert F. Dwyer	Oct. 1963	Present
Neil C. Hurley, Jr.	Apr. 1964	Feb. 1965
Stanley Gewirtz	Dec. 1965	Present
Gerald C. Mann	Dec. 1965	Present
President:		
Robert P. Cramer	Nov. 1962	June 1966
John J. Kirwan (acting)	July 1966	Present
DEPARTMENT OF THE INTERIOR:		
Assistant Secretary--Public Land Management:		
Harry R. Anderson	July 1965	Present
John A. Carver, Jr.	Jan. 1961	Dec. 1964
Assistant Secretary for Administration:		
D. Otis Beasley	Sept. 1952	Dec. 1965

PRINCIPAL OFFICIALS

RESPONSIBLE FOR THE SALE OF

FEDERALLY OWNED ELECTRIC POWER AND

SALT WATER DISTILLATION FACILITIES

TO THE GOVERNMENT OF THE VIRGIN ISLANDS (continued)

	Tenure of office	
	From	To
DEPARTMENT OF THE INTERIOR (continued):		
Director, Office of Territories:		
Ruth G. Van Cleve	Apr. 1964	Present
GENERAL SERVICES ADMINISTRATION:		
Administrator of General Services:		
Lawson B. Knott, Jr.	June 1965	Present
Lawson B. Knott, Jr. (acting)	Nov. 1964	June 1965
Bernard L. Boutin	Nov. 1961	Nov. 1964
Utilization and Disposal Service:		
Commissioner:		
Howard Greenberg	June 1963	July 1966
Property Management and Disposal Service:		
Commissioner:		
John G. Harlan	July 1966	Present

VIRGIN ISLANDS CORPORATION
[illegible]
VIRGIN ISLANDS, U. S. A.
Department of the Interior
Washington, D. C.

CABLE ADDRESS
"VICORP"

August 24, 1966

Hon. Elmer B. Staats
Comptroller General of the
United States
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Staats:

You have requested our comments upon the draft of a proposed report to the Congress entitled "Unauthorized Disposal of Federally Owned Electric Power and Salt Water Distillation Facilities in the Virgin Islands at Inadequately Determined Estimated Fair Market Value."

Our views as to Vicorp's legal authority to make this disposal were set out in our letter to you of August 6, 1965, and again amplified and restated in a letter of November 24, 1965 from our General Counsel to the Secretary to the Board of Directors. Copies of such statements are enclosed for your ready reference.[1] In summary, our position is that Section 4(a) of the Vicorp Act in no event could have been used, since its use is limited to instances where the Board finds that disposal to private enterprise is indicated. In this instant case, the Board, on the contrary, rejected disposal to a private utility and voted instead for sale to a public entity.

With regard to the use of Section 4(f) of the Vicorp Act, the section we did use in fact, we maintain that, although the matter is arguable, we remain satisfied that our use of this section in May, 1965, for the sale of the power system was as valid as was our use of the same section in June 1964 for the sale of the sugar mill and sugar lands of Vicorp, i. e. each disposal was authorized and within the competence of the Board of Directors to authorize. We cite the prior sale of the sugar properties to show that we did not regard our using Section 4(f) in 1965 in the power sale as a strained and dubious exercise to circumvent the proper jurisdiction of the Congress. The Corporation used the same section of the VICORP Act that it had used for the disposal of most of its assets. Please see the attachments referred to above for a complete statement of our legal position.

Insofar as the adequacy of the appraisal report which fixed the fair market value of the subject property at $6.5 million as of September 30, 1964, is concerned, we will defer to the General Services Administration for a technical analysis thereof. At no time did we use or rely upon such appraisal report, and indeed had not even seen it as the time of the May, 1965, sale. In January, 1965, and again in April, 1965, the General Services Administration, having full knowledge of the objections and misgivings of the General Accounting Office, and having

[1] GAO note: Enclosures not included in report because the Corporation's position is summarized herein.

satisfied itself that such objections were without merit, reported to us that the fair market value of this system, was $6.5 million. That was good enough for us, since GSA, as you know, is the Executive Branch's expert in the appraisal and sale of property.

In any event, however, the Government of the Virgin Islands, acting through its Governor, notified the General Services Administration on July 26, 1966 that it would be willing to pay to the Federal Government $9.5 million for this property, in return for a quit-claim deed issued pursuant to the Federal Property and Administrative Services Act of 1949, as amended. We understand that it did so, not from any conviction that the sale of May 28, 1965, was not valid and binding, but rather based upon pragmatic reasons having to do with the desirability of being able to offer its revenue bonds for sale, such bonds to be serviced from proceeds from sales of power and water from the subject system, without the salability of such bonds being prejudiced by the existence of your opinion that the prior sale was invalid. We understand further that such offer will be accepted.

The submission of this statement of views is intended also to respond to your request for the views of the Department of the Interior, which has reviewed your draft report and has been furnished a copy of this response.

Sincerely yours,

John J. Kirwan

John J. Kirwan
Acting President

GENERAL SERVICES ADMINISTRATION

Office of Finance and Administration
Washington 25, D.C. 20405

IN REPLY REFER TO

Mr. Irvine M. Crawford
Assistant Director, Civil
Accounting and Auditing Division
General Accounting Office
Washington, D. C. 20548

FEB 25 1966

Dear Mr. Crawford:

Your letter of December 20, 1965, forwarded, for our review and comment, your proposed report to the Congress on the disposal of Government-owned electric power and salt water distillation facilities in the Virgin Islands.

The proposed report alleges that the General Services Administration did not adequately determine the estimated fair market value of the facilities because GSA accepted the appraisal submitted by a private engineering firm without adequately reviewing the basis for appraisal. In our opinion, this conclusion is not supported by any facts and appears to be based solely on the disagreement by your representatives with the evaluation made by the appraisers and by GSA concerning the reasonableness of deductions for economic obsolescence, the estimate of future operating income, the return of the Federal Government's investment in the salt water distillation facilities, and the estimated fair market value compared with net book value.

As your investigators are aware, many man hours were spent by the GSA appraisers in analyzing the basis and the reasonableness of the appraisal report, in the process of which there were also many discussions with the appraisers.

Estimating the value of utility systems is more difficult than estimating values for other less unique real estate interests.

For this reason, as we advised you in our letter of January 28, 1965, we invited proposals for an appraisal contract from four nationally known engineering companies in the utility field. Engineering expertise is required in order to obtain an adequate appraisal of such facilities, and there can be no doubt that the *** [appraisal firm], which received the appraisal contract, possessed and utilized the necessary engineering talent.

In the course of its review, GSA did evaluate the four factors mentioned above and determined, as a matter of judgment, that the conclusions provided by the appraisal were reasonable. The experience and professional judgment of the *** [appraisal firm] were, of course, among the factors taken into consideration in our evaluation. In the absence of such experience and professional judgment, there would be little point to obtaining a contract appraisal.

It is, therefore, our firm opinion that GSA did discharge its responsibility under the Federal Property and Administrative Services Act of 1949, and that, since estimating fair market value is not an exact science, disagreement with our judgment provides no sound basis for the allegation that our evaluation was inadequate.

All of the matters considered in the proposed report have been the subject of extensive discussions in meetings which we have had with representatives of GAO, including the lengthy meeting of February 15, 1965, which was attended also by representatives of *** [the appraisal firm] and the staff of the Government Activities Subcommittee of the House Committee on Government Operations.

We have certain specific comments with respect to the discussion in the report concerning estimated fair market value:

The deduction of the $2.5 million for economic obsolescence of the facilities was not intended to compensate a purchaser for costs of expansion of the facilities. Instead it reflects the estimated amount considered necessary to provide for a reasonably firm capacity for the present load. Accordingly, we cannot concur with the view that additional income would be generated by the replacement of existing facilities through the future expenditure of an amount equal to the deduction.

We consider the estimate of operating income to be adequately supported and, if anything, weighted in favor of the seller, not the purchaser. Under normal procedure, operating income and expenses over a period of time in the past, in addition to a forecast of future income, are used in connection with the establishment of value based on the earnings approach. The earnings approach used here was based solely on the net earnings of the past year, and did not consider the lower earnings of previous years. In addition, although the operating expenses shown on the books were used by us, we felt that probably they were somewhat on the low side. The fact that modern power production machinery and equipment is far superior to most of that used in the Virgin Islands leads us to believe that the future cost of maintenance and operations will hold down the net earnings of the facilities.

[GAO note.]

With respect to the salt water distillation facilities, Burns & Roe, Inc., consulting engineers for the Virgin Islands Government, mention a water cost from this plant of $2.52 per 1000 gallons as compared to a cost of $1.40 per 1000 gallons for water imported from Puerto Rico. Because of this, in November 1964, a contract was entered into between the Virgin Islands Government and the Westinghouse Corporation to install a water desalting plant, at a cost of $2,650,000, with a 7,500 KW generator and a capacity of

one million gallons of potable water per day. The contract was contingent on acquisition of Virgin Islands Corporation property by the Virgin Islands Government. We mention this contract because of its importance in making a proper analysis of the water situation. It has been reported that the new plant can be reasonably expected to produce water for 90¢ per 1000 gallons. When this cost is compared to the cost of operating the existing plant, and the small size of the existing plant is considered, the conclusion is inescapable that the plant is completely obsolete. This, in itself, is indicative of the uneconomical attributes of the existing distillation plant, and in our opinion lends additional support to the deduction for economic obsolescence which was applied.

We believe that adequate consideration was given to the contract for the sale of water to the Virgin Islands Government. It was not considered appropriate to assign a value to the contract itself, but rather to establish the value of the water distillation facilities by capitalizing the earnings from those facilities together with the earnings from the power facilities, thereby establishing the value of the whole.

The proposed report states that information obtained from the Federal Power Commission on the sale of 15 utility systems throughout the United States since February 1961 discloses that the systems were sold for amounts in excess of net book values. We submit that few utilities are sold, and that when one is sold, its selling price depends upon many more considerations than book value. We believe that further contact with the Federal Power Commission will disclose that public utilities have also been sold for less than net book value.

If net book value, which is an accounting figure based in part on cost less depreciation, is to be given the weight which the report appears to suggest, a utility system made up of substantially obsolete equipment from a technological standpoint should bring the same amount in the open market as a modern, up-to-date system with identical net book value and operating income. We do not think this would be the case. Accounting determinations, while

useful as a factor in establishing value, are only one of the considerations used in arriving at a final judgment.

We appreciate the opportunity to comment on the proposed report.

Sincerely yours,

W. P. Turpin
Assistant Administrator
for Finance and Administration

GAO note: Deleted comments relate to draft report material which had been omitted from our final report.

MAR 2 1967