

SUMMARY

The Office of the Auditor General has conducted a special review of BCDS Manufacturing, Inc. – Shiprock (BCDS) finances pursuant to the authority vested in the Office of the Auditor General by the Navajo Nation Code (12 N.N.C. Chapter 1 Section 1-10).

FINDING I: The Navajo Nation is the only stockholder that contributed capital

BCDS is authorized to issue 50,000 no-par value shares. No-par value stock means there was no nominal dollar amount assigned to the stock at the time of issue. BCDS has on record four stockholders. BCDS incorporator was issued 10,000 (or 20%) shares, two other stockholders were issued 7,250 (or 14.5%) shares each and the Navajo Nation was issued 25,500 (or 51%) shares in exchange for its \$311,290 investment. The Navajo Nation is the only stockholder that provided contributed capital to BCDS. Contributed capital refers to the monetary investment by stockholders through purchase of stock from the corporation. The Division of Economic Development (DED) Executive Director stated that the other three BCDS stockholders were issued shares of stock in exchange for their business expertise and connections, rather than monetary investments.

FINDING II: Personal funds were intermingled with corporate funds

Between the period December 2003 and October 2007, BCDS opened three checking accounts. Compilation of BCDS bank transactions found that of the \$300,000 initial investment by the Navajo Nation, only \$261,817.50 was deposited into BCDS checking account; \$38,182.50 was either cashed out or deposited into another bank account unrelated to BCDS. Furthermore, our analysis of bank activities found BCDS stockholder and former CEO intermingled his personal funds with corporate funds; approximately \$3.0 million personal expenses were paid out of the BCDS checking accounts.

FINDING III: BCDS is in debt for approximately \$4.7 Million

As of December 31, 2007, BCDS is in debt for approximately \$4.7 million. As a corporation, BCDS is a distinct legal entity and its stockholders are not personally liable for the debts and liabilities of the corporation. However, under certain circumstances, an individual stockholder may be liable for BCDS debts. This is referred to as “piercing the corporate veil”. An example of such circumstance is the Navajo Nation guaranteeing the \$2.2 million corporate debt with JP Morgan. Such guarantee poses a risk to the Navajo Nation of losing its personal liability protection. Another example is inter-mingling of personal funds with corporate funds, as reported in Finding II, which may invalidate a stockholder’s personal liability protection.

FINDING IV: Due diligence investigation was not done

Prudent investors conduct due diligence to investigate and identify in advance any risks related to a proposed investment to ensure the planned investment can produce the desired results. DED did not conduct due diligence investigation on BCDS before investing into the company. In addition, the Navajo Dam Review and Selection Committee and the Budget and Finance Committee did not ensure due diligence investigation report was included in the loan proposal package before approving the loan for BCDS. Furthermore, the administrative reviewers of the pledge agreement between the Navajo Nation President and JP Morgan did not ensure that due diligence investigation report was included in the Signature Approval Sheet (SAS) package presented for their review. The Navajo Nation underestimated the risk of guaranteeing a \$2.2 million loan and investing more than \$300,000 into BCDS by failing to ensure due diligence is conducted on the company and its owners.