

PORT AUTHORITY OF GUAM

**INDEPENDENT AUDITORS' REPORT ON
COMPLIANCE AND INTERNAL CONTROL**

SEPTEMBER 30, 2000



**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Directors
Port Authority of Guam:

We have audited the financial statements of the Port Authority of Guam (the Authority) as of and for the year ended September 30, 2000, and have issued our report thereon dated November 5, 2001, which report was qualified due to our inability to obtain information to support the carrying value of inventories and to obtain information to satisfy ourselves as to the collectibility of certain long-term accounts receivable at September 30, 2000. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect the Authority's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as item numbers 00-01 through 00-09.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

This report is intended for the information of the management and the Board of Directors of the Port Authority of Guam, federal awarding agencies, pass-through entities, the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than those specified parties.

Deloitte & Touche LLP

November 5, 2001

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-01 - Recording Significant Transactions

Criteria: Significant non-recurring transactions should be promptly and appropriately recorded upon approval by management. Complete and accurate supporting documentation should exist for the transaction, stating its nature, amount and date.

Condition: The Authority recorded, in fiscal year 2001, a receivable from another government agency of \$1.4 million for Base Realignment and Closure Commission related to expenses incurred in fiscal years 1995 and 1998 through 2000.

Cause: The cause of this condition is unknown.

Effect: At September 30, 2000, long-term receivables were misstated by approximately \$1.4M, and expenses (legal counsel, salaries and wages) were misstated by approximately \$450,000, both before audit adjustment. Because the receivable was not recorded throughout the fiscal year, management and the board of directors may have analyzed the financial statements and made certain decisions without bearing this significant adjustment in mind.

Prior Year: This is a finding carried over from prior year not corrected in the current year.

Recommendation: Upon approval by management, accounting should promptly record all significant adjustments, including all audit adjustments. This will ensure that financial information used by management and the board of directors is accurate and updated for all significant transactions.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

Accounting immediately billed GEDA in FY 2001 for the lump sum amount owed by GEDA since 1995 following a change in senior management.

Accounting did not book the receivable in a timely manner because of the expectation by previous management that the Shipping Repair Facility would be turned over by the federal government to the government of Guam and ultimately to the Port Authority. When the federal government elected not to turn over this facility, a significant period of time had already passed. It was only following a change in senior management that PAG fully researched the matter and subsequently billed GEDA's share of the expenses relating to the BRACC project.

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-02 - Inventory Schedule

Criteria: The Authority should maintain an inventory listing on a regular basis with updated quantities, accurately calculated unit costs and extensions, the total of which should tie to the amount recorded in the G/L.

Condition: The Authority was unable to provide an inventory schedule as described in the first paragraph.

Cause: The cause for this condition is a limitation of the JDE system that will not allow a report to be printed for the required date. However, the Authority should have attempted to produce the required report soon after the September 30, 2000 physical inventory counts were completed, over one year ago.

Effect: We were not able to satisfy ourselves with respect to the recorded amount of inventory at September 30, 2000 and, have qualified our report accordingly.

Recommendation: The Authority should determine the reason for the JDE limitation and resolve it as soon as possible. In the future, all efforts to produce the required report should be made on a regular basis (e.g. monthly). At a minimum, it should be done soon after the annual inventory counts are completed.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

The auditors for FY 1999 and FY 2000 observed and tested the items on the physical inventory for FY 2000 and FY 2001. Reports were presented to them showing the variances of each item and corresponding adjusting entries in the inventory balances.

The JD Edwards system does not have a standard report showing the extended balances of each item and the grand total balance of the physical inventory, which can be compared to general ledger. This problem has been corrected in FY 2002. The Information Technology division created a report that will have all the information needed to check the accuracy of the inventory balance against the general ledger account. Accounting has been requiring the Supply section to do a cycle of various items each month and to perform checks to see the physical count is the same as the JD Edwards system index card. These changes will ensure the integrity of this report in preparation for the physical inventory on September 30, 2002.

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-03 - Construction Work-In-Progress

Criteria: The Construction Work In Progress (CWIP) account should be used in recording capitalizable costs for incomplete property and plant projects. Once a project is certified completed, the total amount should be reclassified to a property and plant asset class account. If a project is terminated and not expected to be completed, any costs incurred that may have future benefit should be capitalized and the remaining costs should be expensed.

Condition: The Port's September 30, 2000 CWIP schedule contained \$585,677 in projects that had been inactive for more than two fiscal years. Per Port officials, these projects incurred only preliminary planning expenses, but the construction contracts were never awarded due to financial constraints.

Cause: The cause of such costs remaining in the active CWIP schedule is unknown.

Effect: CWIP was overstated at September 30, 2000 by \$585,677 prior to our proposed audit adjustment to write off the projects.

Recommendation: Management should assign the Chief Engineer or another responsible official to regularly evaluate the status of ongoing projects at the Port and to report the status to management. The schedule of CWIP should be regularly updated to reflect the current status of all projects. Abandoned, terminated or completed projects should be reported to accounting promptly for capitalization or write off.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

Most of the items that were booked as CWIP were payments made to vendors for Architectural and Engineering studies before a project commences. Projects may only be implemented if there is sufficient local or federal funding. Because of budget constraints, the projects were either discontinued or put on hold. Accounting was not informed of the status of the projects by the Engineering Division, which resulted in those balances remaining in the CWIP account.

Accounting has addressed and resolved this communication problem with the Engineering Division and is now actively monitoring current projects. After the project has been completed or discontinued, it will be reclassified to property, plant, equipment or the cost will be expensed.

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-04 - Property Improvements: Documentation

Criteria: Recorded property, plant and equipment (PP&E) should be properly supported by accurate documentation. This includes the original cost of PP&E and subsequent related improvements or betterments.

Condition: Supporting documentation for the recorded amounts of certain PP&E improvements could not be provided. Furthermore, improvements were not adequately described in the PP&E listings, and it could not be determined which existing PP&E items related to the improvements.

Cause: The cause of this condition is unknown.

Effect: Property, plant and equipment may be overstated by an undetermined amount.

Recommendation: PP&E descriptions should be updated based on currently prepared schedules of the Authority's real property. Overall costs and accumulated depreciation should not be adjusted; however, costs and accumulated depreciation may be allocated based on relative replacement costs or another rational method to assets for which original costs cannot be determined. The Authority should regularly review the estimated useful lives of real property and other significant assets and determine whether accumulated depreciation and annual depreciation expense should be adjusted accordingly.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

Accounting has setup the Fixed Assets Module in the JD Edwards system to identify all the property, plant and equipment owned by the Port Authority. Property, plant and equipment has also been broken down and appropriately classified in the JD Edwards Fixed Assets system. Your recommendation for using the ratio of the replacement cost to the total recorded cost in the PP&E schedule will be implemented in FY2002.

Accounting will also meet with representatives from Equipment Maintenance Division and Property Control Officer to review the estimated useful lives of the assets and determine if replacement engines or parts that have high values should be expensed or capitalized.

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Schedule of Findings and Questioned Costs
September 30, 2000

Finding Number 00-05 - Property, Plant and Equipment

Criteria: To ensure the validity of recorded fixed assets, the Authority should protect the existence of assets by properly tagging, safeguarding and maintaining updated location listings for all movable assets. Records should be revised to reflect assets no longer in the possession of the Authority.

Condition: During fixed asset existence testing, the following asset could not be located in 1999 or 2000.

<u>Class</u>	<u>Item</u>	<u>Section Assigned To</u>	<u>NBV @ 9/30/00</u>
Communication Equip	Smartnet System	Port Police	\$30,825.35

Cause: The cause for this condition is unknown.

Effect: Property, plant and equipment is immaterially misstated.

Recommendation: The Authority should ensure that all personnel are aware of a policy requiring significant events, such as relocations, damages, obsolescence, etc., to be reported to the fixed asset custodian for recording. Assets that are no longer in existence should be promptly written off.

Auditee Response dated May 29, 2002: The Port agrees with the finding that the item could not be located in the prior year. Accounting researched this particular item and found that item does exist. Therefore, property, plant and equipment (PP&E) was not misstated due to this finding.

The Property Control Officer also inquired on this purchase by the Port Authority. The Smartnet System is a package composed of various communication items such as portable radios, battery chargers, adapters, battery maintenance system, and smartnet software used by the Port police. In the old fixed assets listing used by Accounting, the Smartnet system was recorded as a single item, while in the Property Control Officer's list it was broken down into radios, battery chargers, and adapters. This discrepancy has been corrected in the Fixed Assets Module in the JD Edwards system for FY 2001, and Accounting is now ensuring that assets are recorded in a manner consistent with the Property Control Officer's list.

A memorandum has been distributed to all division heads informing them that any transfers, damages and/or obsolescence of assets shall be immediately reported to the Property Control Officer for accountability. The Property Control Officer will also be regularly doing spot checks on certain fixed assets to make sure the assets in the list are accounted for.

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-06 - Accrued Leave Status Report

Criteria: Accounting should regularly reconcile the accrued leave status report with the supporting leave status cards maintained by Payroll for each employee. The status report should exhibit, for each employee, annual leave hours, current hourly rate and computed annual leave amount. The report should also contain a grand total that agrees to the general ledger account balance.

Condition: The Authority did not have an annual leave status report as of September 30, 2000 that details hours, rate and amount by employee. Without such a report, reconciliations of information in the general ledger to independent source documentation (leave status cards maintained by Payroll) cannot be performed.

Cause: The cause of this condition is unknown.

Effect: Accrued payroll and payroll expense may be misstated by an undetermined amount.

Recommendation: Management should immediately create an annual leave status report and should perform periodic reconciliations between the annual leave status report and the general ledger. Exceptions discovered should be reviewed by both Accounting and Payroll to discover cause, and procedures should be implemented to prevent and/or correct such exceptions in the future.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

Accounting immediately requested that the Information Technology Division work on a report for Payroll that will print out the annual leave balance for each employee sorted by section. The report will also show a total balance of the annual leave as of the date of the report is run.

Starting fiscal year 2002, the annual leave year to date report will be submitted monthly by the payroll section to Accounting and checks will be performed to ensure that annual leave balances reconcile with the general ledger balance. Any variance will be investigated by Payroll and Accounting before making any adjustments.

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Schedule of Findings and Questioned Costs
September 30, 2000

Finding Number 00-07 - Annual Leave

Criteria: The payroll system should provide for reliable processing of salaries and wages, related taxes and withholdings, and annual leave accrual and usage. Management should regularly review payroll reports and records to determine that the system is functioning properly and that information used by management in decision making is accurate.

Condition: From January 1, 2000 to September 30, 2000, the new JDEdwards payroll system erroneously recorded annual leave taken (used) to salaries and wages expense. The entry should have charged annual leave against the leave liability already accrued, and therefore expensed, in previous periods.

Cause: The cause is unknown, but relates directly to configuration of the payroll system's entry processing.

Effect: The salaries and wages accounts and the accrued annual leave account were materially overstated (\$566,372) at September 30, 2000 before audit adjustment.

Recommendation: Management should regularly perform thorough reviews of the processing configurations of the payroll and other systems to determine that no erroneous entries are occurring and to prevent further significant processing errors.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

The issue of not being able to take annual leave used in the liability account is a payroll system problem in the JD Edwards financial system (JDE). This problem has been resolved for now by creating another expense account for annual leave taken, creating a recurring entry every month to zero out the annual taken account, and then debiting the liability account.

Adjustments have been made in FY 2001 accounts for all the annual leave taken to be reduced in the liability account. This will provide management with accurate financial comparison information. In the medium term, we are working with JDE to correct this problem in the system.

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Schedule of Findings and Questioned Costs
September 30, 2000

Finding Number 00-08 - Payroll Expense

Criteria: The Port's total wages per the payroll register should agree to the amount recorded on the general ledger.

Condition: In FY00, total amount of salaries and wages per payroll register was materially different from the amount on the General Ledger.

Per General Ledger	Per Payroll Register	Difference
\$13,603,960	\$13,216,378	\$387,582

Per further analysis, it appears that the payroll journal entries created through JDE payroll module are not being reconciled with the payroll register. The journal entries inputted are verified per pay period if they were entered properly; however, no reconciliation is performed to ensure that the amount per the general ledger and the amount per payroll register agree. Also, due to unfamiliarity with the system, the initial upload may have caused some accounts to be grouped incorrectly with respect to object code.

Cause: The cause is primarily unfamiliarity with the JDE system during fiscal year 2000, the first year of use.

Effect: Salaries and wages expense may be misstated.

Recommendation: The Port should perform reconciliations at the end of each pay period to ensure that amounts recorded on the payroll register and amounts on the general ledger agree.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

The Port was experiencing some setup issues with the payroll module in the JD Edwards system. One problem that was discovered in the system was that annual leave expense when taken was hitting the sections expense instead of the liability account. Another issue that was discovered was employees that are labeled as exempt (meaning they are supervisors or superintendents) if the Port pays them overtime expense or night differential it applies on to section's expense. The effect is that the regular salary account in the general ledger is higher than the payroll register. Personnel and payroll staff have corrected the setup problems on the employee's file. Accounting has been regularly reconciling the payroll register and general ledger to make sure the system is properly applying the correct accounts.

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Schedule of Findings and Questioned Costs September 30, 2000

Finding Number 00-09 – Capitalizable Expenditures

Criteria: Expenditures for parts, materials and supplies that have been acquired and that are expected to contribute into the future should be capitalized. Expenditures for computer consulting engagements covered under SOP 98-1 should be treated as specified in the statement.

Condition: Several parts, material and supplies purchased within the Facility Maintenance department that have an extended value into future periods have been expensed rather than capitalized. With respect to the recent IBM / JD Edwards hardware and software purchase, it appears that all costs in the current year were automatically capitalized.

Cause: When purchases are recorded and paid for, items acquired are not being reviewed thoroughly to ensure proper classification. In addition, the capitalization policy does not appear to be enforced consistently. With respect to IBM/JDE, it appears incorrect instructions were handed down to capitalize all costs.

Effect: As such, Parts, Materials, and Supplies expense may be immaterially overstated. In addition, Computer Equipment is overstated.

Prior Year: This is a prior year finding not corrected in the current year.

Recommendation: Management should review controls over disbursements to ensure that amounts are being properly recorded and that the capitalization policy set forth is adhered to. In addition, SOP 98-1 should be thoroughly understood and applied to future expenses incurred related to computer software development and consulting.

Auditee Response dated May 29, 2002: The Port Authority of Guam agrees with this finding.

Accounting is now reviewing the accounts that were assigned to items that have been acquired to determine whether or not the items should be capitalized or expensed. This responsibility has been assigned to the Fixed Assets Accountant and the Property Control Officer. High value items such as parts or materials that will extend the value of equipment or a property are now being capitalized. Computer software development and consulting services that were purchased at the beginning of fiscal year 2002 are now being recorded based on SOP 98-1.