

GUAM POWER AUTHORITY

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

YEAR ENDED SEPTEMBER 30, 2002



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
Guam Power Authority:

We have audited the financial statements of Guam Power Authority (GPA), as of and for the year ended September 30, 2002, and have issued our report thereon dated April 7, 2003. 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 Guam Power 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 GPA'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 GPA'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 items 2002-01 through 2002-08.

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, of the reportable conditions described above, we consider item 2002-08 to be a material weakness.

This report is intended solely for the information and use of the audit committee, management, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

April 7, 2003



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH
REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL
CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors
Guam Power Authority:

Compliance

We have audited the compliance of Guam Power Authority (GPA) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2002. GPA's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 7). Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of GPA's management. Our responsibility is to express an opinion on GPA's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about GPA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on GPA's compliance with those requirements.

In our opinion, GPA complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2002.

Internal Control Over Compliance

The management of GPA is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered GPA's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that may be material weaknesses. 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 noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we noted no matters involving the internal control over compliance and its operations that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of GPA as of and for the year ended September 30, 2002, and have issued our report thereon dated April 7, 2003. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for additional analysis as required by OMB Circular A-133. The accompanying schedules are not a required part of the financial statements. This schedule is the responsibility of the management of GPA. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the financial statements taken as a whole.

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

Deloitte + Touche LLP

April 7, 2003

GUAM POWER AUTHORITY

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

<u>Grantor/CFDA Grantor's Program Title</u>	<u>Federal CFDA Number</u>	<u>FY 2002 Cash Receipts</u>	<u>Expenditures</u>
FEDERAL EMERGENCY MANAGEMENT AGENCY:			
Pass-Through Guam Department of Administration:			
Public Assistance Grants - Typhoon Chata'an	83.544	\$ -	\$ 3,795,771
Hazard Mitigation	83.548	<u>1,849,629</u>	<u>2,838,810</u>
Total Federal Emergency Management Agency		<u>\$ 1,849,629</u>	<u>\$ 6,634,581</u>
Total Federal Awards		<u>\$ 1,849,629</u>	<u>\$ 6,634,581</u>

See notes to schedule of expenditures of federal awards

GUAM POWER AUTHORITY

Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 2002

1. Organization

The Guam Power Authority is a line agency of the Government of Guam, a governmental entity established by the 1950 Organic Act of Guam, as amended, and has the powers of a body corporate, as defined in the act and local statutes. Only the Federal expenditures of the Guam Power Authority are included within the scope of the audit. The U.S. Department of the Interior has been designated as the Government of Guam's cognizant agency for the compliance audit.

2. Summary of Significant Accounting Policies

a. Basis of Accounting

For the purposes of this report, cash receipts relate to all cash derived from the federal agencies, as passed through the Government of Guam Department of Administration. Cash receipts do not include the matching funds from the Guam Power Authority or receipts related to program income.

All expenses and capital outlays that represent the federal share are reported as expenditures. Expenditures are recognized on the accrual basis of accounting, consistent with the manner in which the Guam Power Authority maintains its accounting records.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, one of which was considered a material weakness.
3. No instance of noncompliance considered material to the financial statements was disclosed by the audit.
4. No reportable conditions in internal control over compliance with requirements applicable to major federal awards programs were identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed an unqualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The Organization's major programs were as follows:

<u>Name of Federal Program</u>	<u>Federal/LSC CFDA Number</u>
Public Assistance Grants – Typhoon Chata'an	83.544
Hazard Mitigation	83.548

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs.
9. The Organization did qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Finding</u>	<u>Questioned Costs</u>
2002-01	Internal Audit	\$ -
2002-02	Supporting Documents	\$ -
2002-03	Disconnection Policies	\$ -
2002-04	System Controls Over New Accounts	\$ -
2002-05	Property, Plant and Equipment Subsidiary Ledger	\$ -
2002-06	Collectibility of Inactive Accounts	\$ -
2002-07	Procurement Policies and Procedures	\$ -
2002-08	GovGuam Receivables	\$ -

Part III - Federal Award Findings and Questioned Cost Section

No findings are reportable.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No.: 2002-01
Area: Internal Audit

Criteria:

The internal audit function should be directed by the board of directors, now the Consolidated Commission on Utilities (CCU), to maintain objectivity in the application of internal audit procedures and to avoid the influence of management on the reporting of findings. The CCU has the responsibility for addressing any findings, including evaluating the conditions reported and handing down corrective action plans to management.

Condition:

During the year ended September 30, 2002, the internal audit function was directed by the general manager of GPA.

Cause:

Management believed a greater degree of focus on significant current problems, and thus an overall increase in efficiency, could be achieved through management oversight of the internal audit function.

Effect:

Although greater efficiency may have been achieved, such may have been attained at the expense of objectivity and overall usefulness of information produced by internal audit. Because evaluation of the conditions reported, creation of corrective action plans, and ensuring implementation were all performed by one individual, the internal audit function apparently did not achieve its intended effectiveness.

Recommendation:

Internal audit should be directed by the CCU. GPA management may continue to request that the CCU direct the internal audit to investigate certain problems and situations as deemed necessary.

Auditee Response dated August 14, 2003:

The Internal Auditor now reports to both the CCU and the General Manager as per Authority Policy AP-039. CCU Resolution #2003-10 provides a new protocol for addressing recommendations. Also, the Internal Auditor under new policy has unrestricted access to CCU's Internal Audit Subcommittee.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No.: 2002-02
Area: Supporting Documents

Criteria:

Effort should be made to ensure the proper safekeeping of supporting documents for transactions.

Condition:

Procurement documents for one out of 25 purchases tested could not be located. Unlocated procurement documents relate to a procurement of \$14,999 from Auds N Ends.

Cause:

There appears to be lack of internal control over safekeeping of procurement documents.

Effect:

No known material effect on the financial statements results from this condition. However, the propriety of underlying account balances may be questioned.

Recommendation:

GPA should ensure proper safekeeping of supporting documents.

Auditee Response dated August 14, 2003:

Effective April 2003 Procurement has implemented a central procurement file to better manage and control the purchase order record keeping. There is a clerk assigned specifically to control the issuance of procurement files. Upon the request for a purchase order/bid file the clerk requires the procurement official requesting for the file to sign out for the file and place an out card to indicate the exact whereabouts of the file.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No.: 2002-03
Area: Disconnection Policies

Criteria:

The Guam Power Authority should enforce policies and procedures regarding disconnection of non-paying customers.

Condition:

Of forty-seven accounts tested that had large balances over 120 days outstanding, eighteen should have been disconnected in accordance with GPA policy. However, the following customers were not disconnected:

	<u>Account #</u>	<u>Amount</u>
1	115951	\$ 5,033.67
2	172025	12,456.40
3	177051	4,926.67
4	125349	8,105.78
5	116483	7,026.32
6	179013	15,596.23
7	119013	4,861.33

Cause:

In some cases, GPA may not have sufficient manpower or have knowledge of the exact location of the meter to disconnect non-paying customers.

Effect:

GPA continues to provide power to non-paying customers.

Recommendation:

GPA should follow existing policies and procedures regarding disconnection of non-paying customers.

Auditee Response dated August 14, 2003:

The GM & CCU have placed increased emphasis on compliance with GPA's Collection Policy, with particular emphasis on disconnecting nonpaying customers. The GM and CCU have ceased all promissory notes for further review and fully support Customer Services Division aggressive collection efforts.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No.: 2002-04
Area: Systems Controls Over New Accounts

Criteria:

The Guam Power Authority should ensure that policies, procedures and systems controls exist that prevent customers from reopening another account (in the same physical location) whenever the original account has been disconnected and the outstanding balance is significant and remains outstanding.

Condition:

It appears that the IBM/JD Edwards System does not prevent customers from applying for a new account even though the application for a new account is for a location where an outstanding balance exists. We further noted that disconnected customers with outstanding balances sometimes request other family members to open a new account in the same physical location under a different name.

Cause:

GPA may not have sufficient manpower to monitor instances of accounts being opened in locations that have previously been disconnected due to non-payment of customers.

Effect:

Due to lack of controls within the creation of new accounts, old accounts with large outstanding balances exist resulting in a significant bad debt provision.

Recommendation:

We recommend additional documentation requirements be implemented prior to establishing a new customer account (i.e. showing sale or lease of particular location) in a recently disconnected location to prevent related parties from obtaining power under different names.

Auditee Response dated August 14, 2003:

In an effort to better screen the addition of new customers, a slight modification to the CIS that enabled that system to search for both inactive and active customers and review outstanding balances thus allowing improved review and access to all other accounts. There is also automated monthly reports for overall existing inactive customers and current terminated accounts report to improve Customer Services monitoring capabilities over these accounts.

The Collection Agents are reviewing inactive accounts and formulating inactive demands letters (1st and final notices) to include balance transfers being processed to active accounts. The Customer Service Representatives are enforcing collections of previously inactive account balances before new accounts are being established.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Finding No.: 2002-05
Area: Property, Plant and Equipment: Subsidiary Ledger

Criteria:

Property, plant, and equipment (PP&E) should be properly supported by an accurate subsidiary ledger. Information maintained should include the original cost and subsequent related improvements or betterments. Accurate related depreciation listings should also be maintained.

Condition:

During 2002, the Authority did not maintain detailed PP&E listings, nor does the Authority maintain subsidiary ledgers.

Cause:

Guam Power Authority may not have sufficient manpower to properly inventory items of electric plant. Moreover, the Authority has not maintained a fixed assets register since its inception.

Effect:

The propriety of underlying accounting balances may be questioned. Furthermore, the control procedure of attempting to reconcile physical assets with accounting records is rendered ineffective.

Prior Year Status:

This condition was noted in the prior year and does not appear to have been corrected in the current year.

Recommendation:

We recommend that a full inventory be performed to account for all items. Upon completion of this inventory, a complete listing should be created including asset description, cost, date of acquisition/disposition as applicable, depreciation to date, identifying number and location. This listing should then be compared to accounting records and reconciled accordingly.

Auditee Response dated August 14, 2003:

There has been progress in establishing a subsidiary ledger for assets in Transportation and under General Plant. The major plant accounts are still monitored in large increments (by plant site) but have not yet been reduced to retirement unit components within each major plant asset. Before such an undertaking can begin, it will be necessary to discuss the impact of changing the depreciation because the JD Edwards system can only process depreciation entries by unit and cannot process using group depreciation. It will be necessary to involve Engineering, Facilities, and plant personnel to determine the various retirement units as well as to assign costs.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Finding No.: 2002-06
Area: Collectibility of Inactive (Disconnected) Accounts Receivable

Criteria:

An allowance for doubtful accounts based on historical collection data, should be recorded against inactive accounts receivable.

Condition:

Accounts receivable should be reviewed periodically for collectibility. At September 30, 2002, GPA had \$11.3 million of inactive accounts receivable, with an allowance for doubtful accounts of approximately \$3.3 million recorded against these receivables. An additional allowance of \$6.8 million was recorded during the audit process.

Cause:

It appears that for the last several years, GPA failed to record an allowance against inactive accounts.

Effect:

Net accounts receivable and income/beginning equity were overstated before audit adjustment.

Recommendation:

As accounts are transferred to inactive status, an allowance for doubtful accounts, based on historical collection data, should be recorded against them.

Auditee Response dated August 14, 2003:

During FY 2003, the Credit & Collection System will be performing daily reviews of any customer accounts that have been added to Inactive Accounts. This will allow for ongoing reviews of these accounts and, if necessary, interim adjustments to the Allowance for Doubtful Accounts balance if such is deemed warranted. This will avoid any end of year large adjustments.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Finding No.: 2002-07
Area: Procurement Policies and Procedures

Criteria:

The Authority should adhere to the procedures governing the procurement process, as set forth by Guam Public Law.

Condition:

During our examination of procurement documentation, we noted the following, which are inconsistent with Guam Public Law:

1. GPA could not locate support for Purchase Order (PO) #5402 in the amount of \$14,999.
2. GPA issued a PO #5163 to pay outstanding invoices.
3. Among 25 items tested, 17 were considered 'Emergency', with eight (8) having no evidence of competitive bids.

Cause:

The first inconsistency is caused by a lack of controls over controlling movement of procurement files. Condition 2 is caused by a vendor initiating work without first receiving proper approval in the form of a PO. During FY02, Guam experienced a number of instances of force majeure – two typhoons and earthquakes, which necessitated emergency procurement procedures indicated in condition 3.

Effect:

While individually these items may not have direct financial statement impact, they represent the possibility of mismanaged funds due to lack of proper control over supporting documentation or planning to handle 'emergency' situations.

Recommendation:

GPA should consider efforts to mitigate the amount of procurement that fall under the category of 'emergency'. Recognizing that there will always be a need for 'emergency' procurement, GPA should enforce stricter guidelines as to what items constitute 'emergency' purchases and what items can be foreseen through the use of reasonable and prudent management procedures.

Proper procurement procedures, including the issuance of purchase orders, should occur before vendors provide goods or services.

Auditee Response dated August 14, 2003:

Normal procurement procedures that require approval before obligating funds have been reinforced since April 2003. The proper process for requisitioning and obtaining approvals before the issuance of a purchase order are now being followed.

With regard to blanket purchase orders, effective May 2003 Procurement has implemented a check-and-balance procedure with the end-users. Procurement ensures balances are accurate and monitors to ensure that the blanket purchase order procedures are followed. The end-users are instructed to provide procurement with a copy of every transaction made on a daily basis to ensure that actual balances are kept up-to-date to ensure that purchases do not exceed the actual purchase order amount authorized.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2002

Finding No.: 2002-08
Area: GovGuam Receivables

Criteria:

GPA should enforce policies and procedures regarding disconnection of non-paying customers.

Condition:

GPA receivables from Government of Guam agencies were \$51.5 million at September 30, 2002. This is an increase of approximately \$6.4 million from September 30, 2001 and an increase of almost \$10 million since September 30, 2000.

Approximately \$48.5 of the \$51.5 million is due from four agencies: the Department of Education (DOE), the Department of Public Works (DPW), Guam Waterworks Authority (GWA) and Guam Memorial Hospital Authority (GMHA). DOE and DPW are line agencies of the Government of Guam and receive their funding from the General Fund, while GWA and GMHA are autonomous agencies and have their own sources of funding.

Cause:

GPA has failed to enforce its own policies on disconnection of past due accounts.

Effect:

The question of collectibility of these accounts may lead to an overstatement of accounts and notes receivables and income. This situation may ultimately put GPA in technical default on its outstanding bonds.

Recommendation:

In April 2003, Public Law 27-19 was signed into law. PL 27-19 authorizes the Government of Guam to issue \$218 million of bonds. Approximately \$30 million of the bond proceeds are earmarked to payoff the notes receivable and current accounts of DOE, DPW and GMHA. However, subsequent to the signing of PL 27-19, the Government of Guam's bond rating was downgraded.

Until the bond controversy is resolved, GPA should enter into repayment agreements with the above GovGuam agencies. Terms of these repayment agreements should be strictly enforced and disconnections should be made promptly if the agencies do not make scheduled payments.

Auditee Response dated August 14, 2003:

The Authority continues to monitor the progress of PL 27-19 to determine if the \$30 million bond will indeed be actually issued. It is prepared to undertake whatever action is necessary in the event the \$30 million arrears payments for DOE, DPW and GMHA are not forthcoming.