



OFFICE OF THE PUBLIC AUDITOR

Government of Guam

Financial Highlights for the Year Ended September 30, 2006

July 3, 2007

The FY 2006 Government of Guam (GovGuam) audit was submitted to the Federal Clearinghouse by the June 30, 2007 deadline, the second year in a row the GovGuam audit was submitted on time. We commend the Department of Administration (DOA) for its continued commitment to strive for improvements to its financial management. This is the first year all autonomous agencies presented their audited financial statements, although the independent auditors, Deloitte and Touche, rendered a qualified audit opinion in two areas: inability to determine the sufficiency of the provision for tax refunds currently stated at \$272.9 million (M) and the inadequate accounting records¹ for the Guam Memorial Hospital Authority in regards to the hospital's recorded receivables and capital assets. The FY 2006 GovGuam audit has so far eliminated as many as 18 qualifications since 2001, the first fiscal year under the oversight of the first elected Public Auditor. Although it has been a long and arduous effort, we applaud DOA for this accomplishment and thank Deloitte & Touche for working collaboratively with DOA and OPA.

General Fund's Growing Deficit at \$524.1 M now exceeds a full year's revenue

The government's financial position continues to deteriorate. The underlying problem of the General Fund cash flow remains as the deficit continues to grow to an alarming amount of \$524.1 M or 50.4% increase from FY2005, far exceeding the FY 2006 General Fund revenue projection appropriated at \$437.1 M. Of the \$524.1 M deficit, \$348.4 M comes from the deficit as of FY 2005 (originally at \$344M and increased by \$4.4 M to a restated amount at \$348.4 M); \$123.6 M from the Retiree Cost of Living Allowance judgment, \$30 M additional Earned Income Tax Credit provision, and \$22.1 M from FY 2006 operations. The \$22.1 M FY 2006 operational deficit is the result of the General Fund expenditures exceeding General Fund revenues mainly due to the following:

- \$11.1 M shortfall in revenues based on revenue budget projection of \$443.6 M with actual revenues of \$432.5 M recorded.
- \$7.5 M of non-appropriated expenditures consisting of \$2 M interest for tax refunds, \$4.6 M for GPSS and GMHA interest only payments to the Retirement Fund, and \$885 thousand for processing fees for credit card payments accepted at the Treasurer of Guam.
- \$6.5 M over-expenditure of the Guam Public School System (GPSS).

The deteriorating condition of the General Fund raises a going concern issue of the government of Guam's ability to operate. As a result of this liquidity crisis, on March 9, 2007, Standard & Poors downgraded GovGuam's bond status and placed the government on a CreditWatch with negative implications. However, on June 20, 2007, Standard & Poors removed the credit watch and affirmed GovGuam's 'B' rating on its General Obligation debt. This action was based on the government's fiscal recovery plan reflecting improved cash flows through continued revenue enhancements and cost-containment measures. It should be noted, however, that GovGuam has

¹ For five consecutive years, the hospital had received qualified audit opinions and continues to face a myriad of challenges mainly due to lack of reconciliation of its receivables and capital assets

a long history of structural imbalance and large accumulated deficits that will take years to reduce. Line entities did not spend their budget appropriations by \$17.3 M. Were it not for these allotment control holdbacks, the deficit may have increased by a similar amount.

\$423.3 M actual revenues did not meet projected revenues by \$13.8 M

Not only were projections not met, actual revenues collected of \$423.3 M were lower than last year's \$436.9 M. It was also noted that FY 2007 revenues are projected to be higher at \$469 M.

FY 2006 General Fund revenues decreased by \$13.7 M to \$423.3 M and were comprised mainly of \$355.7 M in taxes (\$197.5 M in income taxes, \$155.4 M in gross receipts taxes, and \$2.8 M in other taxes) and \$59 M in Section 30 funds, which were \$8 M more than what was budgeted. FY 2006 income taxes of \$197.5 M, decreased from FY 2005 by \$27.5 M.²

General Fund liabilities increased tremendously by \$204.9 M to \$617.1 M or a 49.7% increase. This includes a \$267.1 M liability for tax refunds while taxes receivables were \$27.3 M.

Gross receipts taxes increased by a modest 4% from FY 2005 to \$155.4 M, compared to a peak year in FY 1997 of \$184.5 M. Chart 1 graphs historical data between FY 2000 and FY 2006. Chart 2 trends the over-expenditures between FY 2000 and FY 2006.

Chart 1. Government of Guam Revenue Tax Trend

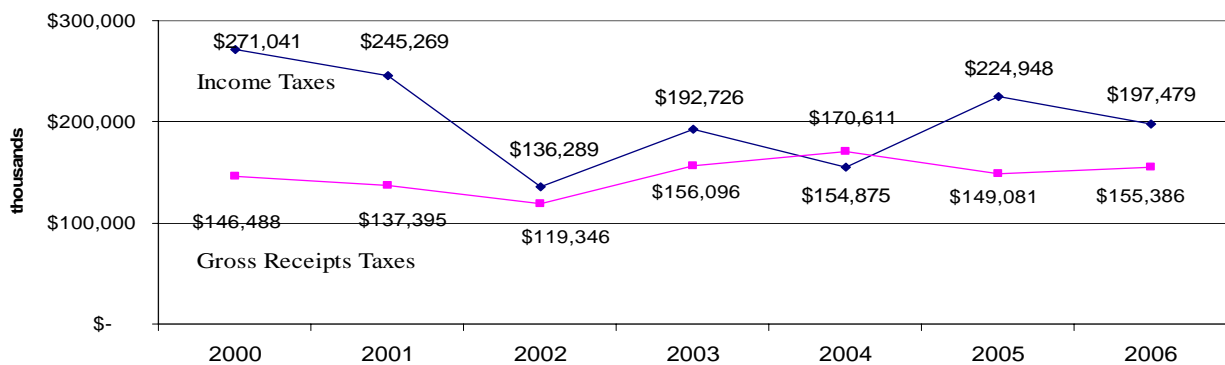
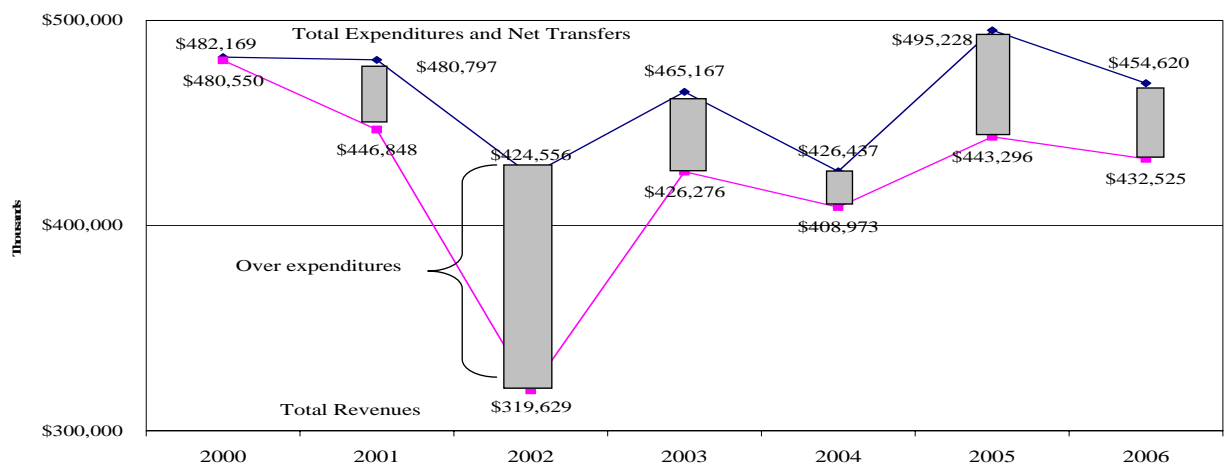


Chart 2. Government of Guam Over-Expenditures Trend



² Although it appears as though FY 2006 income taxes decreased by \$27.5 M, this decrease is negated by a major audit adjustment from a prior year increasing it by \$34 M. The adjustment reflects revisions in the DRT estimate for the provision for tax refunds that auditors were unable to audit. After this adjustment, there is a net increase in income tax of approximately \$7 M.

FY 2006 General Fund expenditures were \$364 or \$4.6 M less than FY 2005. Expenditures in the amount of \$210 M, or 57.7% went to education: public education at \$168.7 M, school bus operations at \$6.5 M, the University of Guam at \$27.3 M, and the Guam Community College at \$7.5 M.

Questioned Costs during FY 2006 increased by 375% to \$2.8 M from \$584 thousand during FY 2005, with one entity as the main contributory factor

Questioned Costs represent GovGuam's Federal grant expenditures that violate the provisions of the grant requirements. The Questioned Costs during FY 2006 increased to \$2.8 M, 375% more than during FY 2005. The largest factor that contributed to this increase arose from the findings under Homeland Security with \$1.6 M questioned costs compared to only \$138 thousand in FY 2005. This finding is consistent with a March 2007 decision by the Office of the Public Auditor-Procurement Appeals which found the sole source procurement inappropriate.³ The remaining \$1.1 M represents questioned costs distributed among seven agencies.

Number of Findings increased to 37

The number of current findings increased to 37, four more than the findings in FY 2005. Of the 37 findings, seven resulted in \$2.2 M, or 80%, of questioned costs for improper procurement. Examples of other procurement violations include insufficient rationale for the selection of a sole source vendor, solicitation of specific brand names, solicitation with less than three quotes, application of small purchase threshold, and absence of complete procurement documentation.

There were two findings for not ensuring de-appropriation of expired federal grants. This resulted in \$155,168 expended beyond the period of availability and thus potentially exposing other amounts to such risk. However, DOA has already made changes to its accounting system to address this finding. One entity exceeded its earmarking requirements by \$101,569 and another entity did not follow guidelines in the required local match by \$77,009. Five entities were in noncompliance with applicable allowable costs/cost principles requirements by \$211,256.

Other findings include:

- One entity did not comply with the cash management guidelines, where the time lapsed between the receipt of Federal funds and the clearance of disbursed checks exceeded the approved one-day clearance pattern.
- Two entities did not comply with applicable tests and provisions requirements of their specific grants. The dollar amount of this non compliance cannot be quantified.
- Three findings were for the lack of eligibility verification. There is a potential that benefits may have been provided to ineligible participants.

Prior years' Questioned Cost of \$7.5 M dollars resolved in FY 2006, leaving \$5.8 M unresolved

According to the FY 2006 Single Audit Reports, overall Questioned Costs decreased by \$7.5 M or 71.6% to \$5.8 M unresolved as of FY 2006. This is a sizeable decrease from the past six years' questioned costs of \$19.2 M as DOA continues to make significant strides in finding resolutions to these questioned costs.

³ An appeal of the Public Auditor's decision is pending with the Superior Court of Guam.

Management Letter identifies reconciliation problems

A separate management letter was also issued to address other findings regarding GovGuam's internal control. Ten findings, two more than FY 2005, were reported and include:

- 55 receivable accounts amounting to at least \$2 M lacked reconciliations and supporting subsidiary ledgers and may pose a potential for a receivable overstatement.
- 28 deposit and other liability accounts amounting to at least \$1.2 M were not reconciled and supported by subsidiary ledgers.
- 30 cash account balances amounting to \$549 thousand were not supported by monthly reconciliations, including certain closed bank accounts still remaining open in the general ledger.
- One liability account for \$448 thousand representing unclaimed checks lack supporting detailed subsidiary ledger, a condition reiterative of prior years' audits findings.
- At least nine revenue accounts were misclassified and un-reconciled against revenues received by at least \$1.1 M.
- Audited Financial Statements of five component units were unavailable.

For a more detailed discussion of GovGuam's financial condition, see the Management's Discussion and Analysis.