

GUAM WATERWORKS AUTHORITY

**INDEPENDENT AUDITORS' REPORT ON
COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING**

SEPTEMBER 30, 1998



**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 Waterworks Authority:

We have audited the financial statements of the Guam Waterworks Authority (GWA) as of and for the year ended September 30, 1998, and have issued our report thereon dated January 28, 1999. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

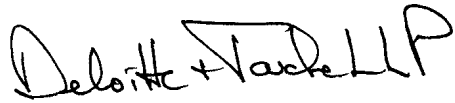
As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on 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 98-1 through 98-19.

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 Guam Waterworks Authority, 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.

A handwritten signature in black ink that reads "Deloitte + Tatchell LLP". The signature is written in a cursive, flowing style.

January 28, 1999

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-1 – Accounts Receivable / Revenue

Criteria:

Proper revenue recognition and recording policies and methods require that credit notes be recorded only with return of sales. Credit notes recorded without return of sales impairs validity.

Condition:

The customer accounting system automatically reverses all estimated billings to the last actual reading in the following situations: an actual reading is entered; a meter change-out occurs; or when the account is closed. In the cases of meter change-outs and closing of accounts, if no ending (actual) reading is entered, the reversal still occurs and is not balanced out. If the customer has been paying estimated billings, the reversal results in a credit. As a result of testing, approximately \$341,000 (\$406,338 x 84%) of such credits (currently recorded in "Other Liabilities") were identified as caused by the above condition.

Cause:

Failure to enter a new or ending actual reading is due to: replacing a defective or damaged meter with another defective one (resulting in non-registering of consumption and thus no reading); not replacing the damaged meter at all as in the case of a customer closing their account and moving away or to another location; or not being able to locate the meter. These causes, in turn, result from the understaffing of the Authority's current task force.

Effect:

Revenue can be understated by a material amount. In addition, customers whose records reflect credit balances because of the above conditions will not pay current charges because the credits will apparently apply to current charges. Thus, current cash flow is impaired. Finally, cash is at risk because customers with credit balances may request refunds, and there is no reason for staff to believe the refund should not be processed. If the problem is not identified, refund checks could be processed. Cash could thus be misexpended.

Recommendation:

The Authority should enter a reasonable reading in such instances. Since it is not specifically stated in the Authority's published rules and regulations that the customer is not required to pay estimated billings, the final reading should be properly estimated and entered as an actual reading to prevent reversal of all previous estimated billings. The Authority should also establish SOP's documenting how to correctly apply the remedy to the foregoing conditions.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-2 – Accounts Receivable and Revenue

Criteria:

The billing section should be staffed by qualified personnel that can process and report financial information accurately and independently.

Condition:

The present billing section is staffed by technicians who rely on outside departments for processing and reporting financial reports for management needs. Additionally, there does not appear to be a specific staff that is charged with the responsibility for producing such financial reports.

Cause:

The staffing pattern of the Authority's billing section does not appear to have been properly reviewed.

Effect:

Management's decisions maybe based on financial information that lacks accuracy.

Recommendation:

The billing section activities revolve mainly around the processing and producing information that bear a direct impact on the Authority's main source of operational revenue. Accordingly, there is a need to staff this section with qualified personnel charged with the responsibility of producing meaningful and accurate financial record keeping and management reporting.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-3 -Allowance for Doubtful Accounts

Criteria:

A method for calculating a reasonable provision for bad debts and related bad debt expense should be developed and consistently used. Such method would be backed by historical information obtained from tracking the aging of receivables.

Condition:

The Authority currently lacks reliable historical information regarding the aging of receivables sufficient to developing a method of calculating a reasonable provision for bad debts. Such lack of monitoring and analysis is coupled with historical lax collection enforcement policies.

Cause:

The cause of this condition is unknown.

Effect:

The effect of the above condition is the overstatement of receivables and income. A more pervasive adverse effect is the inability of the Authority to properly monitor long outstanding accounts and to institute an effective collection policy, both leading to increased expense for the Authority.

Recommendation:

The Authority should begin to accumulate historical information by tracking receivables throughout their life. A method of reviewing and analyzing the information should be developed, allowing calculation of a reasonable provision for doubtful accounts. In addition, the Authority should develop a plan of action for addressing long outstanding accounts, such as intense collection efforts and eventual cut-off of services. The result of such analysis would allow the Authority to reduce uncollectability to a more desirable level.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-4 - Allowance for Doubtful Accounts

Criteria:

Customer accounts which are terminated and still carry an outstanding balance should be paid off before reconnection is made to the service location.

Condition:

Per our discussions with the Manager of Revenue Administration and customer service and billing personnel, it is highly possible that service locations shut off due to non-payment have been re-established under new applications by other persons living at the same location (most likely relatives).

Cause:

There is no control procedure to determine whether the new applications cover the same service location.

Effect:

Receivables age beyond desirable levels and cash flow remains impaired, because attempts to force collection (terminating non-paying accounts) are circumvented by customers.

Recommendation:

The Authority should consider amending connection procedures to include a step to determine whether the service location is currently in a terminated, shut-off status due to non-payment of its previous account.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-5- Inventory SIR's

Criteria:

Stock issue receipts (SIR's) should be used in pre-numbered sequence.

Condition:

There are no controls over the use of pre-numbered SIR's.

Cause:

The SIR booklets are distributed to various divisions at random. Additionally, within the warehouse and the various divisions, the receipts are not used in order.

Effect:

The last SIR used cannot be precisely determined and/or documented.

Recommendation:

The number ranges of the SIR booklets distributed to the various divisions should be documented by the warehouse staff. Furthermore, the divisions and the warehouse staff should use the SIR booklets in sequence.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-6 - Requisition / Supplies

Criteria:

Receiving reports, purchase orders and work orders (trouble reports) should be used in a pre-numbered order.

Condition:

There are no controls over the sequential use of receiving reports, purchase orders or work orders.

Cause:

The abovementioned documents are used at random and are not properly logged.

Effect:

The last receiving report, purchase order or work order used cannot be precisely determined and/or documented.

Recommendation:

The abovementioned documents should be pre-numbered and sequentially used. Additionally, these documents should be filed in numerical order and by date.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-7 - Fixed Assets

Criteria:

Fixed assets should be properly tagged and safeguarded against loss and not be misused or neglected in any way. The duty to ensure that this occurs should be designated to a Fixed Asset Accountant, a person in charge solely of additions, issues, receipts and disposals of fixed assets. The impairment, loss or damage of fixed assets should be reflected on the books via write-down entries.

Condition:

During our physical existence testing, we noted the following:

253 KW Onan Generator Acquired 11/92 Cost \$42,750

Result: Per Kin San Nicolas, it has been moved around so much he is not sure of its current location.

Telexon Meter Reading Device Acquired 3/95 Cost \$2,516

Result: Per Ed Santos, there are currently no such devices. There are seven identical entries on the F/A listing indicating total amount of missing devices costing \$17,612.

In addition, after inspecting the existing Telemetry System, the system did not appear to be in the condition as described in the invoice, purchase order or contract documents and specifications, nor did it appear to function as described in those documents. It was apparent that write-downs of this asset should have been made due to theft, damage and wear and tear. However, no write-downs were noted.

Cause:

The Authority has no formal policy establishing accountability over fixed assets.

Effect:

As a result of this condition, assets are susceptible to loss and/or misuse. Because the lost, damaged or stolen assets must be replaced years before the end of their useful lives, cash outflow increases unnecessarily. The failure to write-down impaired assets to their fair market value or to increase depreciation when required will leave fixed assets overstated. The expense for non-capitalized tools and equipment increases; a condition which lowers net income.

Recommendation:

The Authority should establish, implement and monitor a firm policy creating accountability for fixed assets and equipment purchases. A qualified, trained person should be appointed as fixed asset (plant) accountant, and should perform duties stated in the policy to ensure assets are safeguarded from loss and/or misuse.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-8 - Fixed Assets/Inventory/Payables

Criteria:

The Authority's Inventory Department should ensure proper safekeeping of supporting accounting documents.

Condition:

The following supporting documents, i.e. invoices, were not provided for review:

A. Inventory

<u>Part No</u>	<u>Description</u>	<u>Unit Cost per listing</u>
13-0100	Water meter rw w/strainer/compt.200	\$ 2,076
01-0070	gate valve mj 4 w/components parts	\$ 407
01-0110	12 mj gate valve	\$ 579

B. Payables

<u>Inv Date</u>	<u>Vendor</u>	<u>Amount</u>	<u>Ref / Inv #</u>
11/10/98	Navy Public Works Center	40,353.21	71098 C

C. Operating Expenses

<u>Check Amount</u>	<u>Check #</u>	<u>Document #</u>	<u>Invoice Date</u>	<u>Invoice Amount</u>	<u>Pending Items</u>
N/A	N/A	2527	12/14/97	2,050	Invoice
\$ 5,092	514312	BH-12B	N/A	N/A	Invoice
N/A	N/A	2828	07/21/98	87,490	Invoice
\$ 43,911	4903	D87800354	06/18/98	43,911	Invoice
\$ 2,858	5242	244391	N/A	N/A	Invoice, Check copy

- D. 1. Regarding fixed assets, the Authority was only able to find invoices supporting the acquisition of 20 out of 63 items sampled.
2. Regarding the Telemetry System, a difference of \$1,186,732 between the invoice and the F/A system is due to postings of Telemetry assets under other item headings. The items could not be identified by the Authority.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-8 - Fixed Assets/Inventory/Payables, Continued

Cause:

There appears to be lack of internal controls over the safekeeping of accounting documents.

Effect:

There is no known material effect on the financial statements; however, propriety of underlying accounting balances may be questioned. In the case of fixed assets, lack of record of ownership could jeopardize the control or possession of the asset. In addition, lack of records documenting historical cost could lead to erroneous valuation and recording of assets.

Recommendation:

GWA should ensure proper safekeeping of supporting accounting documents.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-9 – Accounts Payable - Navy

Criteria:

Due to their significant amounts, billings from the Navy for water should be carefully reviewed and checked for accuracy.

Condition:

Navy billings are currently not reviewed by any accounting personnel before payment is processed.

Cause:

There is no explanation for the lack of review of billings from this large vendor.

Effect:

Significant errors may exist in such billings and remain undetected even after payment is made. Cash flow could be unnecessarily impaired and expenses could be overstated.

Recommendation:

The Authority should assign an accounting employee with adequate knowledge and abilities to review Navy billings for accuracy each month. Information should be acquired from Operations in order to compare billings with the Authority's own data on the volume of water purchased. Discrepancies should be investigated and corrected.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-10 - Annual Leave

Criteria:

The Authority's Personnel Department should re-evaluate personnel who do not work and nonetheless stay in active status.

Condition:

For 1 (or 0.8 %) out of 119 employees tested, employee # 98 ceased working effective after ppe 11-22-97.

Cause:

The cause of this condition is unknown.

Effect:

There is no known material effect on financial statements as a result of this condition; however, GWA personnel department should re-evaluate status of employees showing no interest in work.

Recommendation:

GWA personnel department should re-evaluate status of employees showing no interest in work.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-11 - Annual Leave

Criteria:

GWA employees should accrue annual leave hours according to the following guidelines:

<u>Number of Service Years</u>	<u>Accrual Rate Per Pay Period</u>
1 ~ 3	4
3 ~ 15	6
15 and above	8

Condition:

For 20 out of 119 employees tested, the following employees were accruing annual leave hours which differed from the above guidelines.

<u>Employee #</u>	<u>Date of Hire (DOH)</u>	<u>Accrual per DOH</u>	<u>Accrual per GWA</u>
578	10/06/97	4.00	6.00
400	10/30/89	6.00	8.00
10	01/21/86	6.00	8.00
407	11/20/89	6.00	8.00
38	02/01/88	6.00	8.00
22	06/17/96	6.00	8.00
385	05/01/89	6.00	8.00
563	03/13/97	4.00	8.00
546	01/05/96	4.00	6.00
406	11/06/89	6.00	8.00
218	02/06/84	6.00	8.00
13	06/26/95	6.00	8.00
571	08/04/97	4.00	6.00
314	03/03/98	4.00	8.00
377	04/17/89	6.00	8.00
578	10/06/97	4.00	6.00
503	05/18/92	6.00	8.00
618	04/20/98	4.00	4.00
73	12/24/84	6.00	6.00
606	05/18/98	4.00	6.00

Cause:

The cause of this condition is unknown.

Effect:

Accrued annual leave may be misstated.

Recommendation:

The GWA payroll department should accrue annual leave hours for an employee according to applicable guidelines.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-12 - Annual Leave

Criteria:

Departmental timesheets should be summarized by payperiod by timekeepers before being forwarded to the payroll department.

Condition:

Departmental timesheets are prepared by timekeepers and are approved by supervisors on a daily basis instead of summarized for each payperiod.

Cause:

The cause of this condition is unknown.

Effect:

There is no known material effect on the financial statements as a result of this condition; however, a summarized departmental timesheet per pay period would improve organization and control of timesheets, as well as reduce paper supply consumption.

Recommendation:

GWA department timekeepers should summarize departmental timesheets per pay period to improve organization and control of timesheets, as well as to reduce paper supply consumption.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-13 - Customer Deposits

Criteria:

Customer deposits should not remain on the system beyond the point the customer closes the account, at which time the deposit is refunded, or at the point the customer becomes inactive or otherwise delinquent for an excessive period of time, when the deposit should be applied to the outstanding balance.

Condition:

In two instances of subsequent receipts testing, a customer account was closed. However, the guarantee deposit was not immediately applied. (#W9534220 closed 12/29/98 and #W9805201 closed 12/16/98).

Cause:

The cause of this condition is unknown.

Effect:

The effect of allowing deposits to remain on the general ledger for inactive accounts is the overstatement of receivables and liabilities (unapplied deposits).

Recommendation:

The standard procedure for closing accounts and for switching accounts to inactive should include a step for identifying any applicable deposit balance and, if so, applying the deposit to any outstanding balance at the time of closing/making inactive. (If no outstanding balance remains, the deposit should be refunded).

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-14 - Revenue – Fire Hydrants

Criteria:

The Authority should bill for all water consumption, including water used in fire hydrants.

Condition:

The Authority has receivables of \$947,058 related to fire hydrant consumption. The last billing for such charges was on August 8, 1995. Additionally, management has not made a decision regarding the imposition of a separate charge for fire prevention.

Cause:

Such imposition of a separate charge would require a complete cost of service analysis (which has not been performed) and subsequent presentation to the Public Utilities Commission in a docket along with other rate design and rate related issues.

Effect:

A material amount of receivables remains uncollected and revenue may be misstated.

Recommendation:

The Authority should ensure that billings for fire hydrants are duly recorded and should complete a cost of service analysis and address the PUC with a docket requesting a separate rate implementation for fire hydrants, and a determination as to the party(parties) responsible for such charges.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-15 – Water Revenue

Criteria

Billing routes should be rotated among the Authority's Task Force regularly to prevent the possibility of illegal acts by employees and customers (which could occur in the form of meter readers entering a lower reading into the computer in exchange for receiving money from the customer).

Condition

Per our discussions with the billing personnel, the Authority does not rotate billing routes among the four members of the Task Force. In the case that one member is sick, on leave, absent from work or otherwise cannot do the readings for his/her route, this is the only time a different member will do readings for that route.

Cause

There is no explanation for the lack of rotation of billing routes.

Effect

Revenue may be understated due to false readings being reported.

Recommendation

The Authority should develop and implement a plan to rotate billing routes among its Task Force members on a regular basis.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-16 - Water Revenue

Criteria:

Abnormal readings (those appearing on exception reports) should be verified by the Authority's Task Force. Adjustments made should be reflected on all applicable billings before delivery to customers.

Condition:

The Authority currently verifies only a small portion of all exceptions.

Cause:

The Authority's Task Force maybe understaffed, and that lack of manpower may prevent the verification / investigation of all exceptions.

Effect:

Revenue may be misstated due to the absence of adjustments to unverified accounts. Non-registering meters left unidentified will result in unbilled consumption and thus increased water loss.

Recommendation:

All readings appearing on the exception report should be verified. The Authority should weigh the benefit of reducing the likely misstatement of revenue against the cost of paying additional people to verify abnormal readings. The Authority has already addressed the concern of defective, non-registering meters which are most likely causing a substantial percentage of abnormal readings.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-17 - Production/Operations/Revenue (Water Loss)

Criteria:

Water loss should be minimized by maintaining accurate production records, maintaining leak-free water distribution systems, and monitoring / correcting water consumption at the point of metering.

Condition:

Using the best information available from an independent source, we calculated water loss of 457,070,347 gallons/month average, and a total of 3,665,863,340 gallons for fiscal year 1998. The discrepancy is due to no production information available for August and September, 1998. In addition, we could not obtain verification the absence of the accuracy of the water loss figures.

Cause:

The causes of water loss are unidentified and identified water line leaks, internal usage, nonregistering meters, fire hydrant usage and also illegal (nonmetered) usage. The cause of the inadequate record keeping resulting in the incomplete information provided us is unknown. We could not obtain verification of the accuracy of the data, because the Authority is assessing the state of water distribution systems, the issue of fire hydrants and billing problems.

Effect:

The result of such a huge magnitude of water loss is the significant loss of revenue, the increase of expenses for the overworking of well and reservoir systems which pump the water, and otherwise unnecessary purchases from Navy Public Works. If inaccurate or incomplete records are kept, a useful comparison between production and consumption can not be made, and monitoring of problem areas may be misguided and ineffective.

Recommendation:

Accurate and complete information about production and purchases of water for sale must be kept for each month. Information about production for each well and reservoir should be regularly updated and upon any changes. Production figures from Operations and consumption figures from Accounting should be reviewed and compared on a monthly basis as a guide to control water loss. Information produced from these comparisons should be used to guide efforts to correct leaks in distribution lines, nonregistering meters and nonmetered usage. Water purchased from the Navy should be limited to a precalculated amount of water needed, based upon historical amounts of production and consumption for similar periods.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-18 - Purchase Orders

Criteria:

Purchase orders should be issued before actual services/goods are received.

Condition:

For 10 (or 18.52%) out of 54 items tested, the following purchase orders were issued after services/goods were received.

<u>Purchase Order #</u>	<u>Invoice #</u>	<u>Invoice Date</u>	<u>Purchase Order Date</u>
N/A	3847	08/01/98	N/A
N/A	3577		N/A
N/A	1704	08/24/98	N/A
81-1989	TCC-07	06/29/98	07/02/98
81-2234	984	03/05/98	07/30/98
81-1984	TCC-02	06/29/98	07/02/98
81-1630	BH-12B	03/06/98	05/27/98
81-1225	1/25/98	01/25/98	04/08/98
81-1963	305	07/01/98	07/01/98
81-0670	98104	12/23/97	01/02/98

Cause:

The cause of this condition is unknown.

Effect:

There is no known effect material effect on the financial statements; however, the Authority may not be following procurement guidelines.

Recommendation:

Purchase orders should be authorized before any services/goods are to be received.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1998

Finding Number 98-19 - Internal Audit Department

Criteria:

The Authority should consider establishing a qualified Internal Audit Department to perform, among other duties, a check and review procedures on transaction processing, revenue protection, and ensuring departmental adherence to Standard Operating Procedures.

Condition:

There is no existing Internal Audit Department. Hence, none of the above procedures are performed.

Cause:

The cause of this condition is unknown.

Effect:

With the lack of an Internal Audit Department, the Authority faces a greater risk of loss, potential misuse of assets and a potential misstatement of account balances. As a result, a weaker foundation underlies management's assertions about the amounts presented in the financial statements.

Recommendation:

The Authority should consider creation of an Internal Audit Department staffed by qualified professional accountants to perform the necessary duties mentioned above.