

GUAM WATERWORKS AUTHORITY

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

SEPTEMBER 30, 1999



**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, 1999, and have issued our report thereon dated April 14, 2000. 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

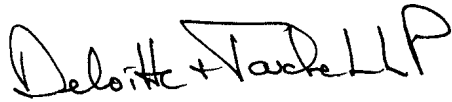
As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on 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 99-1 through 99-15.

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 + Tuck LLP". The signature is written in a cursive, stylized font.

April 14, 2000

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-1 - Supporting Documents

Criteria:

Efforts to ensure the proper safekeeping of supporting documents for transactions should exist.

Condition:

The following supporting documents, i.e. invoices, purchase orders, promissory notes, were not provided for review:

A: A/R – Others

	<u>Acc. Number</u>	<u>Name</u>	<u>Amount</u>
1	WOA9900310	Promissory Note – Private Customer	\$ 5,939.41
2	WOA9900519	Promissory Note – Private Customer	\$ 7,648.57

B: Inventory

	<u>Part Number</u>	<u>Description</u>	<u>Unit Cost Per Listing</u>
1	13-0100	6" Cast Iron Strainer	\$ 2,075.00
2	01-0100	Gate Valve MJ10	\$ 459.00
3	01-0110	Gate Valve CIMJ 12	\$ 579.00
4	01-0070	Gate Valve CIMJ 4 w/ comp	\$ 406.80
5	01-0140	Tapping Valve 4	\$ 350.00
6	12-0100	Full Circle Clamp 10x10	\$ 72.91

C: Operating Expense:

	<u>Check Date</u>	<u>Description</u>	<u>Amount</u>
1	5/25/99	Rental of Heavy Equipment	\$ 8,880.00
2	6/3/99	Rental of Backhoe 4	\$ 9,961.03

Cause:

There appears to be lack of internal control over 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 inventory, lack of historical cost records could lead to erroneous valuation and recording of assets.

Recommendation:

GWA should ensure proper safekeeping of supporting documents.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-1 - Supporting Documents, Continued

Auditee Response dated March 7, 2001:

The JDEdwards software under the new Financial Management Information System has provided a set of processes to better track documentation for conditions A, B, and C. The processes became fully operational in FY 2000.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-2 – Accounts Receivable - Others

Criteria:

Promissory Notes should be signed by the actual customer, unless otherwise noted or documented properly (i.e. power of attorney) regarding who will be signing the note on their behalf.

Condition:

The following note was found to be signed by an unknown party other than the intended customer. Currently, if the customer orally advises the collection agency that they will send someone else to sign the promissory note, the collection department accepts another party's signature.

<u>Account Number</u>	<u>Name</u>	<u>Outstanding Balance</u>
WOA9900311	Promissory Note – Private Customer	\$8,782.38

Cause:

Due to existing economic times and customers' inability to take a few hours off from work, they send relatives, friends or co-workers to sign promissory notes.

Effect:

The promissory note is deemed to be invalid because the collection department does not have documentation as to who signed the note on their behalf. The customer does not appear to be legally bound, as he did not sign the promissory note.

Recommendation:

If circumstances such as this occur, GWA should require a letter from the actual party stating another party will be authorized to sign the promissory note on their behalf.

Auditee Response dated March 7, 2001:

During the FY 2000, the Authority's Revenue Protection Unit (RPU) under the Revenue Administration Section has adopted standard operating procedures that set forth the guidelines in processing promissory notes. These guidelines encompass the above recommendation.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-3 - 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.

Prior Year Status: This is a carryforward finding from the 1998 report to management.

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:

GWA 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.

Auditee Response dated March 7, 2001:

The JDEdwards software under the new Financial Management Information System (FMIS) has provided a set of processes to better track documentation and recording of terminated customer accounts. Additionally, the Authority's Revenue Protection Unit (RPU) under the Revenue Administration Section has adopted standard operating procedures that set forth the guidelines that encompass the above recommendation. The processes became fully operational in FY 2000.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-4 - Inventory

Criteria:

Inventory control should include procedures to properly receive, store and issue materials and supplies. Such procedures should exist in order to maintain accountability for expendable items and to minimize cash outflow for such items.

Condition:

In FY99, GWA did not record receipts in inventory. Instead, the method utilized was to issue all materials and supplies received under each PO to the department originally requesting the items. There is no verification made from outside of the department that items are not wasted, misappropriated or misused.

Cause:

The cause for this change in procedure unknown.

Effect:

Materials and supplies expense is overstated and inventory is understated, both by an undetermined amount. Materials and supplies may be misused, misappropriated or wasted.

Recommendation:

Management should implement a generally accepted inventory method, including control procedures to properly receive, store and issue materials and supplies. Such procedures will help maintain accountability for expendable items and help minimize cash outflow for such items.

Auditee Response dated March 7, 2001:

We concur. The JDEdwards inventory software under the new FMIS is being implemented during the current FY 2001. Included in the implementation process are guidelines to properly receive, store and issue materials and supplies.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-5 - Fixed Assets

Criteria:

Fixed assets should be properly tagged and safeguarded against loss and not misused or neglected in any way. The duty to ensure that this occurs should be given 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:

PY Condition. During our physical existence testing we noted the following:

Pentium 133 Mhz Multimedia System Acquired: 4/25/98 Cost: \$3,115

Note: This computer was originally located at General Manager's Office, Tiyan. The following day, the computer appeared in GWA's main office. Per discussion with plant accountant, it has been moved around so much that she is not sure of its current location.

Computer Notebook with Accessories Acquired: 11/12/97 Cost: \$2,450

Note: This laptop was assigned to Operations. It was sent to Data for repairs at one point. However, it was not present for inspection. After extensive efforts to view the item, it was finally returned to Data, but not until after it was determined that it was inappropriately removed from GWA premises for a significant length of time.

Bushcutter and 2 Cycle Oil	Acquired: 9/23/98	\$ 765
10" sensus #W-5500 Water Meter	Acquired: 4/16/98	\$20,241
ABS Pump AFP1042	Acquired: 1/20/98	\$ 7,185
Shindawa B-45	Acquired: 3/18/98	\$ 2,620

Note: As of fieldwork date, properties stated above could not be located.

Cause:

The Authority has no formal policy creating accountability for 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 & equipment increases, lowering net income.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-5 - Fixed Assets, Continued

Recommendation:

The Authority should establish, implement and monitor a firm policy over 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.

Auditee Response dated March 7, 2001:

We concur. The Authority will exercise stricter adherence on the implementation of policy over accountability for fixed assets and equipment purchased.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-6 – Accounts Payable Trade

Criteria:

Current and accurate payable records should be maintained at all times. Reconciliations of account balances with vendor statements should be done regularly for large accounts and accounts with many transactions. The A/P trade subledger should agree with the general ledger balance.

Condition:

Reconciliations of account balances were not performed regularly for significant accounts. The subledger did not agree with the general ledger balance.

Cause:

The cause is due to the shortage of accounting personnel to perform these steps on a timely basis.

Effect:

The September 30, 1999 accounts payable trade balance per subledger varied from the general ledger by \$504,967. This matter was subsequently corrected through prepared audit adjustments.

Recommendation:

Adequate staff should be maintained to ensure A/P records remain updated and are reconciled on a timely basis, thereby reducing misstated balances, late payments and misunderstandings with vendors.

Auditee Response dated March 7, 2001:

We concur. Management is currently taking steps to adequately staff the Accounts Payable Section through internal transfers from other GovGuam agencies.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-7 – Accounts Payable Trade – Receipts Not Vouchered

Criteria:

All receipts of materials and supplies should be reconciled to purchasing documents, then debited to inventory or expense and credited to A/P trade. In the alternate system employed by GWA, the transaction should include a credit to receipts not vouchered until such time that the vendor invoice is received. Then, receipts not vouchered should be debited and A/P trade credited. The net effect is that receipts not vouchered should result in a zero balance.

Condition:

During 1999, GWA failed to record the entry required for the receipt of materials and supplies, but did record the entry for vendor invoices.

Cause:

The cause of this condition is unknown.

Effect:

The lack of the entry to credit receipts not vouchered caused a debit balance in the account. Consequently, materials and supplies expense is understated by the amount of the receipts not vouchered balance, or \$630,042. (Materials and supplies expense is the account affected and not material and supplies inventory due to client's method of expensing receipts in FY99 to the requesting department.)

Recommendation:

As the department required for making the entry to record receipts is Procurement and Supplies, closer supervision and review of P&S by Accounting should occur. Procedures should include monthly reconciliations of P&S records with Accounting records.

Auditee Response dated March 7, 2001:

The JD Edwards software under the new Financial Management Information System has provided a set of processes to address this condition. The processes became fully operational in FY 2000.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-8 – 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.

Prior Year Status:

This is a carryforward finding from the 1998 report to management.

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.

Auditee Response dated March 7, 2001:

The Authority concurs with this recommendation. Upon fully staffing the Task Force unit, we will implement the above recommendation.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-9 - 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.

Prior Year Status:

This is a carryforward finding from the 1998 report to management.

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.

Auditee Response dated March 7, 2001:

We concur. The JDEdwards inventory software under the new FMIS is being implemented during the current FY 2001. Included in the implementation process are guidelines to properly receive, store and issue materials and supplies.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-10 - Revenues – Water Production vs. Consumption

Criteria:

Water losses should be properly monitored in order to identify weaknesses in the distribution system such as leaks, non-registering meters, theft and other unbilled consumption. A basic monitoring procedure is the comparison of water production vs. consumption, which should be done on a regular basis using reliable data.

Condition:

No reliable data exists supporting production figures for FY99; therefore, no meaningful production vs. consumption comparisons can be made in the CY.

Cause:

The cause of this condition is unknown.

Effect:

Because no meaningful information can be produced, the Authority is not precisely aware of the extent of existing leaks, non-registering meters, theft and other unbilled consumption. Efforts to improve water distribution are hampered, and the amount of lost revenues cannot be quantified.

Recommendation:

Accurate monthly water production records should be maintained. Comparisons of production vs. consumption using reliable information should be performed monthly.

Auditee Response dated March 7, 2001:

We concur with the finding. A staff has been identified to accumulate water data and furnish production and consumption report to management on a monthly basis.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-11 - Overtime

Criteria:

Overtime is necessary for GWA to adequately address emergencies, reporting deadlines, shortages in staff and similar problems. All overtime should be pre-approved by department heads, and overtime claimed by employees should be reviewed by the employee's supervisor for reasonableness and correctness. It should be management's policy to minimize overtime.

Condition:

- 1) We noted 4 instances when an error was made by paying an employee overtime in excess of 16 hours on a weekday, as 8 regular hours plus 16 overtime hours equals 24 total hours in the day.
- 2) We noted 186 instances when overtime of between 10 to 15 hours was paid to employees on weekdays. It would appear unreasonable when considering the employee worked an additional 8 regular hours (totaling 18 or more hours) and would need time to drive to and from work and time to sleep. Several times, employees claimed apparently excessive overtime hours two days in a row, which forces the question of sleep and travel time.
- 3) An arbitrary amount of 30% was chosen as the threshold when considering excessiveness of total overtime paid during the year compared to annual salary. We noted 48 employees who earned overtime in excess of this threshold.

Cause:

The cause of this condition is unknown.

Effect:

Without proper management control, excessive overtime results, some of which may not be legitimate, and some of which is legitimate but could be reduced or eliminated. Salaries and wages could be overstated by an undetermined amount.

Recommendation:

Management should pre-approve all overtime. Overtime claimed by employees should be reviewed by the supervisor for reasonableness and correctness. Options to overtime should be explored, such as outsourcing the necessary manpower in times of emergency, report deadlines or staff shortages.

Auditee Response dated March 7, 2001:

We concur. The Authority has restricted overtime to emergency cases.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-12 - Operating Expenses

Criteria:

Operating expenses related to a fiscal period should be recorded in that fiscal period and should be supported by proper documentation.

Condition:

Approximately \$426,000 of operating expenses had not been recorded in the FY99 financial statements under audit.

Cause:

The cause of this condition may be the shortage of experienced accounting manpower at and immediately after year end.

Effect:

Net income was materially overstated, and liabilities materially understated, prior to adjustment by the auditors.

Recommendation:

Proper supervision and review should exist to ensure that all invoices are recorded, with special attention given to the workload assigned to each accountant. Adjustments necessary to ensure no accounting processes suffer due to shortage of manpower should be made immediately.

Auditee Response dated March 7, 2001:

We concur. Management is currently taking steps to adequately staff the Accounts Payable Section through internal transfers from other Government of Guam agencies.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-13 - Communications Expense

Criteria:

Due to the wide usage of cellular communication throughout GWA, billings should be reviewed to determine that airtime is restricted to business use. Such review should be visibly documented on the invoices.

Condition:

No visible documentation existed to prove that control procedures regarding communications expense were performed.

Cause:

The cause of this condition is unknown.

Effect:

Communications expense for GWA for the FY ended 9/30/99 may be misstated by an undetermined amount.

Recommendation:

Regular review should be done for all cellular airtime billings. Appropriate action should be taken to prevent usage of cellular communication for other than business use.

Auditee Response dated March 7, 2001:

Public Law 25-72 passed in September 30, 1999 prohibited payment of cell phone services with government funds throughout the Government of Guam agencies, which included all autonomous agencies. GWA management has strictly implemented the provisions of this Public Law.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-14 - Purchase Orders

Criteria:

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

Condition:

For 4 (or 20%) out of 20 items tested, purchase orders were never issued although the services/goods were received.

<u>Description</u>	<u>Invoice Date</u>
Equipment Rental	11/10/98
Equipment Rental	11/20/98
Equipment Rental	10/03/99
Equipment Rental	03/29/99

Cause:

The cause of this condition is unknown.

Effect:

There is no known material effect on the financial statements. However, Guam Waterworks Authority is not following its procurement regulations.

Recommendation:

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

Auditee Response dated March 7, 2001:

We concur.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 1999

Finding Number 99-15 - Internal Audit Department

Criteria:

The Authority should consider establishing a qualified Internal Audit Department to perform, among other duties, 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.

Prior Year Status: This is a carryforward finding from the 1998 report to management.

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.

Auditee Response dated March 7, 2001:

The Authority is currently making arrangements with another public utility agency that has an established Internal Audit Section to share in the cost and services to perform internal audit duties and responsibilities.