

GUAM WATERWORKS AUTHORITY

**FINANCIAL STATEMENTS AND
INDEPENDENT AUDITORS' REPORT**

YEAR ENDED SEPTEMBER 30, 1998



INDEPENDENT AUDITORS' REPORT

The Board of Directors
Guam Waterworks Authority:

We have audited the accompanying balance sheet of Guam Waterworks Authority (GWA) a component unit of the Government of Guam, as of September 30, 1998, and the related statements of operations and deficit and cash flows for the year then ended. These financial statements are the responsibility of GWA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, 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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Governmental Accounting Standards Board Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*, requires disclosure of certain matters regarding the year 2000 issue. Guam Waterworks Authority has included such disclosures in note 7. Because of the unprecedented nature of the year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Accordingly, insufficient audit evidence exists to support Guam Waterworks Authority's disclosures with respect to the year 2000 issue made in note 7. Further, we do not provide assurance that Guam Waterworks Authority is or will be year 2000 ready, that Guam Waterworks Authority's year 2000 remediation efforts will be successful in whole or in part, or that parties with which Guam Waterworks Authority does business will be year 2000 ready.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding year 2000 disclosures, such financial statements present fairly, in all material respects, the financial position of Guam Waterworks Authority as of September 30, 1998, and the results of its operations and its cash flows for the year then ended, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 28, 1999, on our consideration of the Guam Waterworks Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants.

January 28, 1999

GUAM WATERWORKS AUTHORITY

Balance Sheet
September 30, 1998

ASSETS

Property, plant and equipment:	
Utility plant in service	\$ 324,988,118
Non utility property	13,769,123
Construction work in progress	<u>18,505,986</u>
	357,263,227
Less accumulated depreciation	<u>(110,652,441)</u>
Total property, plant and equipment	<u>246,610,786</u>
Current assets:	
Cash:	
Unrestricted	1,099,413
Restricted (note 12)	3,474,098
Accounts receivable, net (note 2)	10,889,869
Materials and supplies inventory, net of allowance for obsolescence of \$400,000	<u>424,643</u>
Total current assets	<u>15,888,023</u>
	\$ <u>262,498,809</u>

See accompanying notes to financial statements.

GUAM WATERWORKS AUTHORITY

Balance Sheet, Continued
September 30, 1998

CAPITALIZATION AND LIABILITIES

Capitalization:

Contributed capital:

Grants by Government of Guam	\$ 124,798,617
Grants by U.S. Government	58,422,152
Contributions-in-aid of construction	59,885,171
Contributions from other agencies	<u>1,211,924</u>

Total contributed capital 244,317,864

Deficit (17,111,580)

Total capitalization 227,206,284

Long-term debt, less current maturities (note 3) 1,016,472

Current liabilities:

Current maturities of long-term debt (note 3) 302,341

Accounts payable:

Operations	14,915,460
Others	279,416

Accrued payroll and employees' benefits 1,062,044

Current portion of employees' annual leave 449,750

Interest payable 196,452

Contractor's payable 1,943,715

Customer deposits 1,127,140

Total current liabilities 20,276,318

Employees' annual leave, less current portion 1,577,238

Retirement fund deferred contributions (note 4) 8,308,865

Advances for construction 3,446,813

Other liabilities 666,819

Total liabilities 35,292,525

Commitments and contingencies (notes 7 and 9) \$ 262,498,809

See accompanying notes to financial statements.

GUAM WATERWORKS AUTHORITY

Statement of Operations and Deficit Year Ended September 30, 1998

Revenues (note 5):	
Water	\$ 24,610,501
Wastewater	12,991,528
Other	<u>39,613</u>
	<u>37,641,642</u>
Operating and maintenance expenses:	
Water purchases	7,659,117
Power purchases	<u>6,462,047</u>
	14,121,164
Salaries and wages	17,127,218
Administrative and general	12,105,861
Depreciation	10,537,899
Contractual	<u>4,210,094</u>
Total operating and maintenance expenses	<u>58,102,236</u>
Operating loss	<u>(20,460,594)</u>
Other (expense) income:	
Interest expense	(196,452)
Interest income	<u>67,378</u>
	<u>(129,074)</u>
Net loss	(20,589,668)
Depreciation on fixed assets acquired with contributed capital (notes 1 and 11)	<u>7,831,563</u>
Net increase in deficit	(12,758,105)
Deficit at beginning of year:	
As previously stated	(96,197,463)
Adjustments (note 10)	<u>91,843,988</u>
As restated	<u>(4,353,475)</u>
Deficit at end of year	\$ <u>(17,111,580)</u>

See accompanying notes to financial statements.

GUAM WATERWORKS AUTHORITY

Statement of Cash Flows Year Ended September 30, 1998

Increase (decrease) in cash

Cash flows from operating activities:

Cash received from customers \$ 31,083,088

Cash payments to suppliers and employees for goods and services (33,952,095)

Net cash used in operating activities (2,869,007)

Cash flows from capital and related financing activities:

Interest expense paid (196,452)

Contributed capital received 21,948,177

Acquisition of utility plant (20,363,636)

Cash received on long-term debt acquired 1,318,813

Net cash provided by capital and related financing activities 2,706,902

Cash flows from investing activities:

Transfers from restricted fund (note 12) 699,248

Interest income received 67,378

Net cash provided by investing activities 766,626

Net increase in cash 604,521

Unrestricted cash at beginning of year 494,892

Unrestricted cash at end of year \$ 1,099,413

Noncash investing, capital and financing activities:

In 1998, a private consultant conducted appraisals of all of Guam Waterworks Authority's utility plant in service. The result was the recognition of \$147,067,406 of fixed assets at cost, and \$58,205,759 of related accumulated depreciation.

See accompanying notes to financial statements.

GUAM WATERWORKS AUTHORITY

Statements of Cash Flows, Continued Year Ended September 30, 1998

Reconciliation of operating loss to net cash used in operating activities:

Operating loss	\$ (20,460,594)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	10,537,899
Bad debt expense	7,304,874
(Increase) decrease in assets:	
Accounts receivable	(7,042,514)
Materials and supplies inventory	589,404
Other assets	483,960
Increase (decrease) in liabilities:	
Accounts payable	7,336,046
Accrued payroll	136,790
Employees' annual leave	71,546
Customer deposits	155,151
Other liabilities	248,301
Advances for construction	(1,792,761)
Retirement fund deferred contributions	<u>(437,109)</u>
Net cash used in operating activities	\$ <u>(2,869,007)</u>

See accompanying notes to financial statements.

GUAM WATERWORKS AUTHORITY

Notes to Financial Statements
September 30, 1998

(1) Organization Summary of Significant Accounting Policies

Organization: The Guam Waterworks Authority (GWA) is a component unit of the Government of Guam (GovGuam). GWA is subject to the regulations of the Public Utility Commission of Guam (PUC). GWA became an autonomous agency in 1996 under Public Law 23-119 and derives its revenues mainly from its water and wastewater system. The water system is engaged in the collection, transmission, and distribution of water to villages and communities of Guam. The wastewater system is engaged in the interception and treatment of wastewater from residences and industries in the villages of Guam. GWA is governed by seven-member Board of Directors appointed by the Governor of Guam which determines such matters as rates and charges for services, approval of contracts and GWA policies.

Basis of Accounting: GWA is accounted for on a “flow of economic resources management focus,” using the accrual basis of accounting. Under this method, all assets and liabilities associated with operations are included on the balance sheet, and revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Materials and Supplies Inventories: Materials and supplies inventory are stated at the lower of cost or market with cost determined under the first-in, first-out method.

Contributed Capital: Government funded projects are recorded as contributed capital as the cost of the projects are incurred. Approved capital grants not yet received amounted to approximately \$2.8 million at September 30, 1998.

Property, Plant and Equipment: Plant in service amounting to \$324,988,118 at September 30, 1998 is stated at estimated historical cost determined by an independent engineering consultant. Non-utility property and equipment are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets (5 - 50 years for plant assets).

During the year, GWA changed its estimate of the depreciable lives of certain non-utility property to more closely approximate their economic useful lives. The change had the effect of increasing net loss by \$1,739,284 for the year ended September 30, 1998.

During the year, GWA also adjusted the policy of charging depreciation expense on assets acquired with contributed capital to the respective capital account (note 11).

Accrued Annual Leave: Compensated absences are accrued and reported as a liability in the period earned. Annual leave expected to be paid out within the next fiscal year is accrued and is included in current liabilities. Employees are credited with vacation leave at rates of 104, 156 or 208 hours per fiscal year, depending upon their service time with GWA. Accumulation of such vacation credits is normally limited to 480 hours at fiscal year end however, management has exercised its authority in certain conditions to allow accumulation of up to 720 hours. All such vacation credit is convertible to pay upon termination of employment.

GUAM WATERWORKS AUTHORITY

Notes to Financial Statements
September 30, 1998

(1) Organization Summary of Significant Accounting Policies, Continued

Revenue: Customer water meters are read on a cyclical basis throughout a monthly period depending on the route schedules of the Guam Power Authority (GPA) pursuant to a combined billing system arrangement between GWA and GPA. Revenue is recognized in the period that meters are read. Wastewater treatment rates are presently at a flat rate of \$20 per month for residential accounts and 80% of current water consumption for commercial and government accounts.

(2) Accounts Receivable

Accounts receivable at September 30, 1998, is summarized as follows:

Customers:	
Private	\$ 12,098,273
Government	<u>5,259,829</u>
	17,358,102
Federal agencies	2,408,854
GPA	378,250
Others	<u>68,889</u>
	20,214,095
Less allowance for doubtful receivables	<u>(9,324,226)</u>
	\$ <u>10,889,869</u>

Substantially all of GWA's customer accounts receivable are from individuals, companies and government agencies based in Guam.

(3) Long-Term Debt

Long-term debt represents invoices financed by IBM relating to the installation of GWA's accounting and operating systems, payable in equal monthly installments of \$26,398 until 2003, including interest ranging from 5.25% to 7.07%. GWA has a \$2.6 million credit line with IBM Credit Corporation. The purpose is for the preapproved purchase of software and hardware systems, technical training and support of such systems, and related expenses. As of September 30, 1998, GWA has used \$1,318,813 of its credit line.

Minimum future long-term debt payments through the year 2003 are as follows:

1999	\$ 302,341
2000	230,000
2001	250,000
2002	280,000
2003	<u>256,472</u>
	\$ <u>1,318,813</u>

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Notes to Financial Statements September 30, 1998

(4) Employees' Retirement Plan

Employees of GWA hired before September 30, 1995 are under the Government of Guam Employees' Retirement System (a defined benefit, contributory pension plan). Employees hired after September 30, 1995, are members of the new Defined Contribution Retirement System (DCRS). Until 1998, those employees who are members of the defined benefit plan with less than 20 years of service at September 30, 1995, have the option to switch to the Defined Contribution Retirement System. Otherwise, they remain under the old plan.

The Defined Benefit Plan and the DCRS are administered by the Government of Guam Retirement Fund, to which GWA contributes based upon a fixed percentage of the payroll for those employees who are members of the Plan.

As a result of the most recent actuarial valuation performed as of September 30, 1995, it has been determined that for the year ended September 30, 1998, a minimum combined employer and employee contribution rate of 28.1% of covered Defined Benefit Plan payroll is required to appropriately fund the current cost, amortize prior service costs and provide for interest on the unfunded accrued liability. Statutory contribution rates for employee and employer contributions were 9.5% and 18.6%, respectively, for the year ended September 30, 1998. The effect of GWA's prior year accruals for its share of pension underfunding reduces the actuarially determined employer contribution rate from 18.6% to an effective rate of 15.29% for the year ended September 30, 1998. In recognition of the above, an accrual reduction of 3.31% of covered payroll is necessary to reduce the unfunded liability based on the difference between the effective rate of 15.29% and the employer's statutory rate of 18.6%.

The plan utilized the actuarial cost method termed "entry age normal" with an assumed rate of return of 8% and an assumed salary scale increase of 6.5% per annum. The most recent actuarial valuation performed as of September 30, 1995, did not provide a breakdown of actuarial present value of vested and non-vested accumulated plan benefits by sponsor or net assets available for benefits by sponsor. If the actuarial valuation were performed for the GWA as a separate sponsor, the accrued unfunded liability at September 30, 1998 and previously may be materially different than that recorded in the accompanying financial statements.

Contributions into the DCRS by members are based on an automatic deduction of 5% of the member's regular base pay. The contribution is periodically deposited into an individual annuity account within the DCRS. Employees are afforded the opportunity to select from different annuity accounts available under the DCRS.

Employer contributions into the DCRS are based on a statutory amount of 18.6% of the member's regular base pay. Of the amount contributed by the employer, only 5% of the member's regular base pay is deposited into the member's individual annuity account. The remaining 13.6% is contributed towards the unfunded liability of the defined benefit plan.

Members of the DCRS who have completed five years of government service, and have attained the age of 55 years at termination, have a vested balance of 100% of both member and employer contributions plus any earnings thereon. Members who have completed five years of service, but have not attained the age of 55, are eligible only for the amount of member contributions plus any earnings thereon.

The cost to GWA for retirement contributions for the year ended September 30, 1998 amounted to \$2,657,297.

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Notes to Financial Statements
September 30, 1998

(5) Real Estate Properties Transferred by Government of Guam

The Government of Guam, pursuant to Public Law 23-119, assigned to GWA various real estate properties under GWA's administration. As of September 30, 1998, the properties have not been recognized in the financial statements pending completion of formal transfer proceedings.

(6) Agreements with the United States Navy

Pursuant to a Memorandum of Agreement, the United States Navy supplies water through its water system to GWA for distribution and resale to non-military customers. Total purchases from the United States Navy for the year ended September 30, 1998 are approximately \$7,799,000.

(7) Commitments and Contingencies

Claims

The United States Navy is claiming for recovery of payment for water allegedly provided by the U.S. Navy to the former Public Utility Agency of Guam and to GWA. Both parties are currently attempting to negotiate a settlement of the dispute. Because an estimate of the amount or range of potential loss cannot be determined at this time, no provision for any liability that may result from such claims has been made in the financial statements.

Self Insurance

GWA has adopted a policy of self-insuring its utility plant-in-service.

Contract Commitments

Contract commitments in connection with projects currently in construction amount to approximately \$7,709,000 at September 30, 1998.

Purchase Commitments

At September 30, 1998, open purchase orders totalled approximately \$280,000.

Year 2000

The year 2000 issue is the result of shortcomings in many electronic data processing systems and other electronic equipment that may adversely affect GWA's operations as early as fiscal year 1999. GWA has identified computer systems and other electronic equipment, which may be affected by the year 2000 issue and estimates that approximately \$150,000 will be needed to upgrade such systems. GWA is currently in the remediation stage of addressing the Y2K issues.

Because of the unprecedented nature of the year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the year 2000 and thereafter. Management cannot assure that GWA is or will be year 2000 ready, that GWA's remediation efforts will be successful in whole or in part, or that parties with whom GWA does business will be year 2000 ready.

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Notes to Financial Statements
September 30, 1998

(7) Commitments and Contingencies, Continued

Medicare

The Government of Guam and its component units, including GWA, began withholding and remitting funds to the U.S. Social Security System for the health insurance component of its salaries and wages effective October 1998. Prior to that date, the Government of Guam did not withhold or remit Medicare payments to the U.S. Social Security System. If the Government is found to be liable for Medicare payments on salaries and wages prior to October 1998, an indeterminate liability could result. It has been the practice of GWA and all other component units of the Government of Guam that payment of this health insurance component is optional prior to October 1998. Therefore, no liability for any amount which may ultimately arise from this matter has been recorded in the accompanying financial statements.

(8) Cash and Cash Equivalents

Bank balances of demand and time deposit accounts held in the name of GWA totalled \$4,540,890 as of September 30, 1998. Of this amount, \$200,000 is insured by the Federal Deposit Insurance Corporation and the remaining balance is uninsured and uncollateralized. In addition, \$31,120 and \$1,500, respectively, were held on hand for the exchange fund and petty cash.

(9) Other Matters

- a. In December 1997, a major typhoon struck Guam resulting in damages to GWA's plant assets of approximately \$10 million. The Federal Emergency Agency (FEMA) has initially determined damages amounting to approximately \$4.6 million to be eligible for FEMA reimbursement at a rate of 90%. Final FEMA recoveries may differ materially from the amount initially determined. Due to this uncertainty, the estimated loss from typhoon damages of approximately \$5.86 million has not been accrued by GWA.
- b. On December 31, 1989, the Government of Guam issued general obligation Water System Revenue Bonds, Series 1989 in the amount of \$49,190,000. The bonds have been issued for the purpose of expanding and improving the existing water system of the Government operated by GWA. The bond obligation is currently recognized by the Government of Guam.

(10) Changes in Capitalization

Changes in capitalization during the year ended September 30, 1998, are as follows:

	Previously Reported September 30, 1997 <u>Balance</u>	Net Prior Period Adjustments <u>Adjustments</u>	Other Adjustment <u>Adjustment</u>	Net Loss <u>Loss</u>	1998 Ending Balance <u>Balance</u>
Contributed capital	\$ 283,768,064	\$ -	\$ 61,230,751	\$ -	\$ 344,998,815
Accumulated depreciation, contributed assets	<u>-</u>	<u>(92,849,388)</u>	<u>-</u>	<u>(7,831,563)</u>	<u>(100,680,951)</u>
	283,768,064	(92,849,388)	61,230,751	(7,831,563)	244,317,864
Deficit	<u>(96,197,463)</u>	<u>91,843,988</u>	<u>-</u>	<u>(12,758,105)</u>	<u>(17,111,580)</u>
	<u>\$ 187,570,601</u>	<u>\$ (1,005,400)</u>	<u>\$ 61,230,751</u>	<u>\$ (20,589,668)</u>	<u>\$ 227,206,284</u>

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Notes to Financial Statements
September 30, 1998

(10) Changes in Capitalization, Continued

Prior period adjustments principally represent correction of overstatement of capital contributions from the Government of Guam, Federal agencies and private developers, due to the non-recognition of accumulated depreciation on contributed assets (note 11) in prior years. Other adjustments principally represent the recording of assets at estimated historical cost as discussed in note 1.

(11) Depreciation on Contributed Assets

Depreciation on fixed assets financed with contributions is closed to the appropriate contributions account at the end of the year. The 1998 depreciation on contributed assets is broken down as follows:

Government of Guam	\$ 4,807,409
Federal government	2,109,442
Contributions-in-aid of construction (private entities)	<u>914,712</u>
	\$ <u>7,831,563</u>

(12) System Development Fund

Public Law 19-47 created the Water and Sewer Development Fund that authorized GWA to establish and implement a water and sewer system development charge schedule, which assesses a charge on each user who connects for the first time on any certain property onto the island's water or wastewater system, or to each builder if the density of development connected to the system is increased. Thus, such charge schedule takes into account any existing infrastructure on the property, present and future user demands, requirements for water and/or sewer services and installation of infrastructure to be done by the builder.

The fund shall be expended only for expanding, upgrading or repairing water and wastewater facilities on Guam. Such restricted cash is placed in various savings and time certificate of deposit accounts. In 1998, the net decrease in restricted cash equaled \$699,248. The decrease represents transfers to the unrestricted fund for the purposes previously mentioned in this note.