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May 30, 2013

Mr. Martin Roush
General Manager
Guam Waterworks Authority
P.O. Box 3010
Hagatna, Guam 96932

Dear Mr. Roush:

In planning and performing our audit of the financial statements of Guam Waterworks Authority (GWA) as of and for the year ended September 30, 2012 (on which we have issued our report dated May 30, 2013, 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, we considered GWA's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of GWA's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of GWA's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to GWA's internal control over financial reporting as of September 30, 2012 that we wish to bring to your attention. We have also separately reported in a letter dated May 30, 2013 addressed to GWA's management certain deficiencies involving GWA's information technology environment.

We have also issued a separate report to the Consolidated Commission on Utilities, also dated May 30, 2013, on our consideration of GWA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the Consolidated Commission on Utilities, management, others within the organization, the Office of Public Accountability - Guam and the Federal cognizant agency and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of GWA for their cooperation and assistance during the course of this engagement.

Very truly yours,

Deloitte + Touche LLP

SECTION I –DEFICIENCIES

We identified the following deficiencies involving GWA's internal control over financial reporting as of September 30, 2012, that we wish to bring to your attention:

1. <u>Fire Hydrants Receivables</u>

   As of September 30, 2012, fire hydrant receivables of $6,546,311 (fully provided for in the allowance for uncollectible receivables) have been outstanding for several years and this amount did not change since fiscal year 2008.

   We recommend that long outstanding fire hydrant receivables be written off.

2. <u>Inventory Reconciliation</u>

   The reconciliation of the year-end inventory count, sub-ledger and general ledger took a considerable amount of time and was completed in February 2013.

   We recommend existing inventory procedures be reviewed and a determination as to whether automation or other enhancements can occur to improve year-end inventory reconciliation processes.

3. <u>Inventory Count – Offsite Locations</u>

   During inventory reconciliation, the Accounting Department discovered that inventories existed at certain locations but were not counted. A subsequent count revealed two locations with $63,010 of inventories, one location that did not have inventory and one location that was not counted.

   We recommend that inventory be planned and coordinated and cover all locations.

4. <u>Monitoring of Construction in Progress (CIP)</u>

   Of twenty-three construction in progress (CIP) accounts tested as of September 31, 2012 aggregating $41,363,554, the following were noted:

   a. Ten projects totaling $17,968,695 related to upgrades, rehabilitations, replacements or retrofits of existing plant/fixed assets. An assessment/review of the potential effect of these CIP projects on existing plant/fixed asset net book values and estimated useful lives is not evident.

   b. Six projects totaling $17,898,681 were completed as of September 30, 2012. This was corrected in February 2013 through an adjustment.

   CIP additions during 2012 amounted to $32,639,845 compared to $14,461,955 in 2011. The level of CIP activities is expected to further increase in subsequent years.

   We recommend GWA continue to enhance timely communication (i.e. quarterly, monthly) between engineering and accounting as to the status of CIP projects, capitalization periods and related matters and such communication be documented (i.e. minutes of meeting, memos, etc.). Further, we recommend that completed projects be timely closed to fixed assets.

SECTION I –DEFICIENCIES, CONTINUED

5. Construction in Progress (CIP) Additions

   Of thirty-nine additions to construction in progress tested aggregating $15,171,115, the following were noted:

   a. Two items totaling $582,042 were for vehicle purchases and were non-CIP related.

   b. One $42,728 transaction related to replacement of pumps and cables and did not require substantial time (i.e. less than a month) to complete. Further, the replaced asset was not identified and was not removed from the fixed asset register as of September 30, 2012.

   c. One $64,950 addition was for prepaid vehicle maintenance.

   We recommend GWA exclude non-CIP expenditures from CIP additions and consider recording capitalizable non-CIP expenditures/inventory issuances directly to appropriate fixed asset accounts.

6. Year-End Adjustments

   Eighty-six adjustments were made to the September 30, 2012 trial balance generated on November 21, 2012. A significant portion of these adjustments related to fixed assets, construction in progress and related accounts.

   We recommend month-end closing and financial reporting review processes be strengthened to minimize year-end adjustments.

SECTION II – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit,* is as follows:

A *deficiency* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

GWA's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.