

GUAM POWER AUTHORITY

**INDEPENDENT AUDITORS' REPORTS ON
COMPLIANCE AND ON INTERNAL CONTROL**

YEAR ENDED SEPTEMBER 30, 2006

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND COMPLIANCE AND OTHER MATTERS BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Consolidated Commission on Utilities:

We have audited the financial statements of Guam Power Authority (GPA), as of and for the year ended September 30, 2006, and have issued our report thereon dated March 28, 2007. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered GPA'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 an opinion 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 GPA'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 items 2006-01 through 2006-09.

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 caused by error or fraud 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, of the reportable conditions described above, we consider items 2006-01 and 2006-02 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Guam Power 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*.

We also noted other matters involving the internal control over financial reporting, which we have reported to management of GPA in a separate letter dated March 28, 2007.

This report is intended for the information and use of the Consolidated Commission on Utilities, management of GPA, the Office of the Public Auditor of Guam, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP
March 28, 2007

**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON INTERNAL
CONTROL OVER COMPLIANCE AND ON THE SCHEDULE OF EXPENDITURES OF
FEDERAL AWARDS**

Consolidated Commission on Utilities:

Compliance

We have audited the compliance of Guam Power Authority (GPA) with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2006. GPA's major federal program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (page 7). Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of GPA's management. Our responsibility is to express an opinion on GPA's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about GPA's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on GPA's compliance with those requirements.

In our opinion, GPA complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended September 30, 2006.

Internal Control Over Compliance

The management of GPA is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered GPA's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. 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 noncompliance with applicable requirements of laws, regulations, contracts and grants caused by error or fraud that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, we believe that the reportable condition described above is not a material weakness. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of GPA as of and for the year ended September 30, 2006, and have issued our report thereon dated March 28, 2007. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for additional analysis as required by OMB Circular A-133. The accompanying schedule is not a required part of the basic financial statements. This schedule is the responsibility of the management of GPA. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects when considered in relation to the basic financial statements taken as a whole.

This report is intended for the information and use of the Consolidated Commission on Utilities and management of GPA, the Office of the Public Auditor of Guam, federal awarding agencies, pass-through entities, and the cognizant audit and other federal agencies, and is not intended to be, and should not be, used by anyone other than these specified parties.

Deloitte & Touche LLP
March 28, 2007

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Schedule of Expenditures of Federal Awards
Year Ended September 30, 2006

Grantor/CFDA Grantor's Program Title	Federal CFDA Number	Receivable balance September 30, 2005	FY 2006 Expenditures	FY 2006 Cash Receipts	Fy 2006 Adjustments	Receivable balance September 30, 2006
Hazard Mitigation Project	CFDA#97.039	\$ 1,114,961	\$ 2,080,058	\$ 1,585,007	\$ -	\$ 1,610,012
Public Assistance Grant - Typhoon Pongsona	CFDA#97.036	\$ 804,920	\$ 637,824	\$ 941,438	\$ -	\$ 501,306
Public Assistance Grant - Typhoon Chata'an	CFDA#97.036	1,177,747	-	1,042,519	(312,768)	(177,540)
Total Public Assistance Grant		<u>1,982,667</u>	<u>637,824</u>	<u>1,983,957</u>	<u>(312,768)</u>	<u>323,766</u>
Total Federal Awards		\$ <u>3,097,628</u>	\$ <u>2,717,882</u>	\$ <u>3,568,964</u>	<u>(312,768)</u>	\$ <u>1,933,778</u>

See notes to schedule of expenditures of federal awards.

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Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 2006

1. Organization

The Guam Power Authority is a component unit of the Government of Guam, a governmental entity established by the 1950 Organic Act of Guam, as amended, and has the powers of a body corporate, as defined in the act and local statutes. Only the Federal expenditures of the Guam Power Authority are included within the scope of the audit. The U.S. Department of the Interior has been designated as the Government of Guam's cognizant agency for the compliance audit.

2. Summary of Significant Accounting Policies

a. Basis of Accounting

The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting. For the purposes of this report, cash receipts relate to all cash derived from the federal agencies, as passed through the Government of Guam Department of Administration. Cash receipts do not include the matching funds from the Guam Power Authority or receipts related to program income.

All expenses and capital outlays that represent the federal share are reported as expenditures. Expenditures are recognized on the accrual basis of accounting, consistent with the manner in which the Guam Power Authority maintains its accounting records.

3. Adjustments

The adjustment to the typhoon Chata'an public assistance grant is to write off disallowed costs and close out the grant with the grantor agency.

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Schedule of Findings and Questioned Costs
Year Ended September 30, 2006

Part I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. Reportable conditions in internal control over financial reporting were identified, one of which was considered a material weakness.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. A reportable condition in internal control over compliance with requirements applicable to major federal awards programs was identified.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.

7. GPA's major program was as follows:

<u>Name of Federal Program</u>	<u>Federal/LSC CFDA Number</u>
Hazard Mitigation Projects	97.033
Public Assistance	97.036

8. GPA did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Part II - Financial Statement Findings Section

<u>Reference Number</u>	<u>Finding</u>
2006-01	Property, Plant and Equipment Subsidiary Ledger
2006-02	Government of Guam Receivables
2006-03	Accounts Receivable Aging
2006-04	Fuel Inventory
2006-05	Accounts Receivable
2006-06	General Plant Assets
2006-07	Meter Reading Exception Reports
2006-08	Materials and Supplies Inventory
2006-09	Private Outdoor Lighting Receivables

Part III – Federal Program Findings Section

No items are reportable.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-01
Area: Property, Plant and Equipment Subsidiary Ledger

Criteria:

Property, plant, and equipment (PP&E) should be supported by accurate subsidiary ledgers. Information maintained should include the original cost and related improvements or betterments. Accurate depreciation listings should also be maintained.

Condition:

GPA does not maintain detailed PP&E listings or subsidiary ledgers of the production, transmission and distribution plant, which represents \$598 million of \$810 million of GPA's plant, at cost.

Cause:

In the past, GPA has not had sufficient manpower to inventory electric plant. Moreover, GPA has not maintained a fixed asset register since its inception.

Effect:

The propriety of underlying account balances may be questioned. Furthermore, the control procedure of attempting to reconcile physical assets with accounting records is rendered ineffective.

Prior Year Status:

This condition was noted in prior years and does not appear to have been corrected in the current year.

Recommendation:

We recommend that a full inventory of plant assets be performed. Upon completion of this inventory, a complete listing should be created inclusive of asset descriptions, costs, dates of acquisition/disposition as applicable, depreciation to date, identifying numbers and location. This listing should then be compared to accounting records and should be reconciled accordingly.

Auditee Response:

GPA has made substantial progress on the creation of a fixed asset subsidiary ledger. The project should be completed by March 2008.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-02
Area: Government of Guam Receivables

Criteria:

GPA's revenue bond covenants require that electric power not be provided to any entity free of charge.

Condition:

At September 30, 2006, the Guam Department of Public Works (DPW) owes GPA approximately \$14 million in notes and accounts receivable. Most of these receivables resulted from power provided for public street lights from 1999 through 2003.

DPW has not made any payments on its note receivable and has unpaid accounts receivable of approximately \$3 million that have been outstanding for several years. DPW is paying for its current year power usage.

DPW is a line agency of the Government of Guam and is dependent on the General Fund to meet its obligations to GPA.

Cause:

For several years, several GovGuam agencies did not pay their power bills and GPA failed to enforce its policies with respect to disconnection of non-paying customers. Since March 2003, GPA has been waiting for resolution of litigation regarding the legality of a bond issuance by the Government of Guam. A portion of the bond proceeds was earmarked to pay the DPW outstanding balances with GPA.

Effect:

GPA has suffered restricted cash flow and has been required to borrow additional funds on the commercial paper market to make up for the cash shortfall.

Recommendation:

On March 27, 2007, the U.S. Supreme Court issued its opinion on the bond litigation which effectively killed the existing planned bond issuance. It has yet to be determined if the bonds may be issued in a smaller amount or if GovGuam's debt ceiling may be adjusted, allowing a larger bond issuance.

GPA should negotiate a repayment agreement for the past due DPW accounts receivable. Compliance with the terms of that agreement and the existing repayment agreement with DPW should be closely monitored. If DPW violates the terms of these agreements, the GPA disconnection policy should be enforced.

Auditee Response:

In January 2003, the Guam Power Authority was placed under a new governance structure wherein the authority to hire management, establish policy, and enter into contracts is vested with a five member elected Consolidated Commission on Utilities (CCU).

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-02, Continued
Area: Government of Guam Receivables

Auditee Response:, Continued

The problems stated in this finding existed prior to the time the CCU assumed governance of the utility. In fact, it is likely these problems were the impetus for the establishment of a new governance structure. Shortly after the Commission took office, a policy was adopted wherein GPA was required to treat all customers in a non-discriminatory manner, i.e. the government customers had to be disconnected in accordance with its service rules just like any other customer class. The Commissioners met with the Legislature and the Governor to address the past due billing and both parties agreed the past due amounts would be repaid through the issuance of a bond.

Subsequent to the meeting, the Legislature passed a bill authorizing the issuance of bonds to repay this debt to GPA. The Governor signed the bill into law.

Later, after objections were raised by Guam's Attorney General, the Legislature revised its borrowing legislation, passed the bill, and the Governor again signed the bill into law.

The Attorney General took the matter to court due to concern over whether or not Guam's borrowing capacity had been exceeded. This legal process took a number of years to resolve. The matter was eventually adjudicated by the United States Supreme Court and while the Court ruled in favor of the Attorney General on a technical definition, the court did not take any action to inhibit the ability of the Governor and the Legislature to establish the formula governing the borrowing capacity of the island. It is absolutely clear from the ruling that the government's debt ceiling may be adjusted by local officials.

Since the CCU took office, all government accounts have been paid on a current basis and the few entities that have become delinquent have promptly been disconnected.

While it is true that it is unlikely the government bond issuance can go forward under existing legislation, GPA believes the U.S. Supreme Court has clearly stated that the ability to establish the formula for the borrowing cap lies in the hands of the Governor and the Legislature. These elected officials have only just begun to wrestle with issues of how its past due obligations will be funded and what the appropriate balance of cost-cutting, revenue enhancements, and borrowing will be in light of the recent opinion of the court. GPA is of the opinion that the government's financial position cannot be resolved without some type of additional borrowing and as the island's elected officials go through the process of identifying and evaluating solutions to its financial condition, this realization will come.

GPA takes this matter very seriously and is committed to ensuring these government receivables are collected.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-03
Area: Accounts Receivable Aging

Criteria:

A reliable accounts receivable aging report should be in place to assist in analyzing outstanding accounts.

Condition:

In 2006, GPA's trade accounts receivable were not correctly aged.

Cause:

The cause of the condition appears to be that uploaded balances from UCIS defaulted to a "current" aged category in Utiligy. Furthermore, there are differences in the criteria between UCIS and Utiligy that resulted in difficulty in importing the aging program from UCIS reporting to crystal reports.

Effect:

No effect on the financial statements results from the condition, but monitoring of receivables may be based on inaccurate information.

Recommendation:

Receivable monitoring is an important tool for GPA to ensure that overdue accounts are addressed in accordance with Service Rules. The aging report should be regularly reviewed.

Auditee Response:

This problem resulted from the conversion to a new customer information system. GPA believes the problems in getting accurate aging reports from the system have been substantially resolved.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-04
Area: Fuel Inventory

Criteria:

Fuel consumption should be closely monitored and differences in various fuel usage monitoring reports should be investigated.

Condition:

Differences between the Peterra reports and receipts recorded by each plant are not being investigated.

Furthermore, fuel inventory consumption based on the generation department reports differs from the accounting department volume. Currently, there is no formal policy as to the level of discrepancies that warrant an investigation.

Cause:

There is no formal policy as to the level of usage differences that warrant an investigation.

Effect:

This condition could result in unauthorized usage or loss of fuel inventory.

Recommendation:

GPA should institute a formal written policy on the investigation of the consumption differences between the physical count and the actual plant consumption. Furthermore, to ensure that the actual plants' consumption is accurately recorded, calibration of fuel gauges should be regularly checked.

Auditee Response:

GPA concurs with this finding.

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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-05
Area: Accounts Receivable

Criteria:

Active accounts receivable should be closely monitored to minimize write-offs and bad debt.

Condition:

Over the past six years, receivables transferred to inactive accounts have averaged more than \$2 million per year. As of September 30, 2006, total inactive accounts amounted to \$19.7 million.

Cause:

While disconnections of past due accounts are generally performed in a timely manner, existing service rules and regulations may limit collection actions.

Effect:

This condition results in increased bad debt expense and negative cash flow.

Prior Year Status

This condition was noted in prior years and does not appear to have been corrected in the current year.

Recommendation:

GPA should review its credit and collection policies and procedures. Such review may entail a revision of existing customer service rules and regulations. GPA should consider hiring an experienced credit and collection manager.

Auditee Response:

GPA concurs that the inactive accounts need to be monitored more closely and an adjustment to write off long past due receivables will be brought to the Consolidated Commission on Utilities for approval prior to April 30, 2007.

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Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-06
Area: General Plant Assets

Criteria:

General plant assets should be inventoried at least once every two years. Plant asset records, including records of asset locations, should be updated after each inventory

Condition:

We noted the following during tests of fixed assets:

- Three of 20 bush cutters could not be located
- One of 15 Epson printers was not located
- One of 10 personal computers was not in the possession of the responsible individual. The asset was later located at a different location.
- One of four Panasonic Toughbooks could not be located.
- Assets are not assigned an asset number. Also, supporting documents, such as purchase orders and invoices, were not always available to assist in identifying assets.

Cause:

Fixed asset registers are not maintained and transfers of assets between locations are not monitored.

Effect:

There is a possibility that the plant assets account is misstated and the depreciation computation may not be accurate.

Prior Year Status:

This condition was noted in prior audits and does not appear to have been corrected in the current year.

Recommendation:

Inventories of general plant assets should be performed at least bi-annually. Assigning assets an identification would assist in monitoring movements and in recording disposals. Futhermore, GPA should ensure proper safekeeping of documents, such as invoices or purchase orders, to support assets acquired.

Auditee Response:

GPA will begin biannual fixed asset inventories as portions of its fixed asset listing are created. Many of GPA's assets are tagged with an asset number; however, GPA needs to use asset numbers that tie to the fixed asset system as the system is being developed.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-07
Area: Meter Reading Exception Reports

Criteria:

Billing exception report thresholds should be established to ensure that customer power usage outside of established criteria automatically trigger a re-reading of the customer's meter.

Condition:

We noted the following during our testing of exception reports:

- 16 of 50 samples are exception report items that are not within the exception criteria. This results in inefficiencies due to time expended reviewing these reports rather than focusing efforts on real exceptions. Too much time appears to be spent investigating accurate readings.
- Two of 50 samples disclosed that the system estimate was used in the generation of billings, but the estimate type used was not indicated. This prevents verification and documentation for future reference.
- In all exception reports (50) examined, there is no evidence that hash totals are used to ensure the completeness of the exception listings.
- Two of 50 samples had incorrect previous readings and present reading KWH, resulting in exception reports for items that should have been correct.
- For one of 50 samples, demand read as verified by the meter reader was not input into the customer subsystem. This resulted in a reading based on the minimum as set by the system, and not on the actual read.
- One of 50 samples was included in the meter reading exception report due to the meter being removed. Utility was not updated for this information. Final resolution as to the meter exception report was not indicated. A monthly customer charge is still being assessed to this service address.

Cause:

GPA is still in the process of ensuring that exception report criteria are well-defined.

Effect:

There could be a question as to the validity of recorded receivables. In addition, unproductive time is incurred in verifying correct meter readings.

Recommendation:

Exception reports should be designed to ensure that only meter readings outside of established criteria are flagged to be re-read.

Auditee Response:

GPA concedes that it has had problems setting appropriate parameters for its billing exception reports since the installation of its new billing software. GPA is working urgently to correct these billing cycle problems.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2006

Finding No.: 2006-08
Area: Materials and Supplies Inventory

Criteria:

Perpetual inventory records should be consistently updated for all inventory movements. Significant variances between inventory counts and perpetual records should be researched.

Condition:

For Transmission and Distribution, 21 of 30 inventory items tested have differences between the physical count and perpetual records. Furthermore, reconciliation of inventory quantities to the perpetual records took several days because several items required verification.

Cause:

It appears GPA lacks adequate controls to monitor inventory movement.

Effect:

No known material effect on the financial statements results from this condition. However, inventory usage recorded in management accounts may not be correct.

Prior Year Status:

This condition was noted in the prior years and does not appear to have been corrected in the current year.

Recommendation:

We recommend that GPA investigate implementation of a cycle count system to update perpetual records and reduce time spent on the year end physical inventory process.

Auditee Response:

GPA is conducting quarterly test counts to ensure such variances are identified on a timely basis.

GUAM POWER AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2006

Finding No.: 2006-09
Area: Private Outdoor Lighting Receivables

Criteria:

Service regulations dealing with termination of customer service should be consistently enforced.

Condition:

For seven of nine private outdoor lighting (rate H) accounts tested, the customers had not made a payment in a year or more but the accounts were still active and were being billed.

Cause:

We were informed that GPA lacks appropriate equipment to disconnect streetlights, so non-paying accounts remain active.

Effect:

Ultimately, bad debts may increase.

Recommendation:

Private streetlights should be disconnected in accordance with service regulations.

Auditee Response:

GPA is working to identify a bucket truck for use by the disconnection crew.

GUAM POWER AUTHORITY

Resolution of Prior Year Findings and Questioned Costs
Year Ended September 30, 2006

The status of unresolved questioned costs from prior year Single Audit Reports is as follows:

Questioned Costs per the September 30, 2004 audit report	\$ 11,956
Questioned Costs per the September 30, 2005 audit report	<u> -</u>
Total unresolved questioned costs as of September 30, 2006	\$ <u>11,956</u>