

GUAM WATERWORKS AUTHORITY

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

SEPTEMBER 30, 2005

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 the Guam Waterworks Authority (the Authority) as of and for the year ended September 30, 2005, and have issued our report thereon dated April 13, 2006. 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 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. The reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as items number 2005-01 to 2005-05.

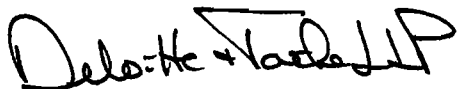
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected 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 the reportable conditions described above are not material weaknesses.

Compliance and Other Matters

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*.

However, we noted other matters involving the internal control over financial reporting that we have reported to management of the Authority in a separate letter dated April 13, 2006.

This report is intended for the information of the management of the Guam Waterworks Authority, the Consolidated Commission on Utilities, the Office of the Public Auditor of Guam, 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, appearing to read "Deloitte + Touche LLP". The signature is stylized and written in a cursive-like font.

April 13, 2006

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

Consolidated Commission on Utilities:

Compliance

We have audited the compliance of the Guam Waterworks Authority (the Authority) 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, 2005. The Authority's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority'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 the Authority'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 the Authority's compliance with those requirements.

As described in item 2005-01 in the accompanying Schedule of Findings and Questioned Costs, the Authority did not comply with the requirement regarding cash management that is applicable to its Environmental Protection Agency (66.418, 66.468, 66.600) programs. Compliance with such requirement is necessary, in our opinion, for the Authority to comply with requirements applicable to its program.

In our opinion, except for the noncompliance described in the preceding paragraph, the Authority complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2005.

Internal Control Over Compliance

The management of the Authority 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 the Authority'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.

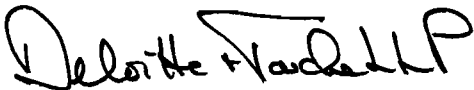
We noted a matter involving the internal control over compliance and its operation that we consider to be reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Authority's ability to administer a major federal program in accordance with applicable requirements of laws, regulations, contracts, and grants. The reportable condition is described in the accompanying Schedule of Findings and Questioned Costs as item 2005-01.

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 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. Our consideration of the internal control over compliance 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 the reportable condition described above is not a material weakness.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Guam Waterworks Authority as of and for the year ended September 30, 2005, and have issued our report thereon dated April 13, 2006. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Supplementary Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. This schedule is the responsibility of the management of the Authority. Such information has been subjected to the auditing procedures applied in our audit of the 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 of the management of the Guam Waterworks Authority, the Consolidated Commission on Utilities, the Office of the Public Auditor of Guam, 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.



April 13, 2006

GUAM WATERWORKS AUTHORITY

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2005

CFDA #	Federal Grantor/Program Title	Accrued (Deferred) Balance at September 30, 2004	Expenditures	Cash Receipts	Accrued (Deferred) Balance at September 30, 2005
U.S. Department of the Interior					
Pass-Through Government of Guam Department of Administration					
15.875	Economic, Social and Political Development of the Territories and Freely Associated States	\$ 287,561	\$ -	\$ -	\$ 287,561
	Total U.S. Department of the Interior	<u>287,561</u>	<u>-</u>	<u>-</u>	<u>287,561</u>
U.S. Environmental Protection Agency					
Direct Grant					
66.418	Construction Grants for Wastewater Treatment Works	53,279	1,500,236 *	(1,389,534)	163,981
66.468	Safe Drinking Water State Revolving Fund	-	221,115 *	(221,115)	-
66.600	Comprehensive Water Resources Master Plan - Phase I	208,000	942,000 *	(1,150,000)	-
66.606	Surveys - Studies, Investigation - Spec	-	75,600	(75,600)	-
	Total U.S. Environmental Protection Agency	<u>261,279</u>	<u>2,738,951</u>	<u>(2,836,249)</u>	<u>163,981</u>
Federal Emergency Management Agency					
Pass-Through Government of Guam Department of Administration					
83.544	Public Assistance Grants	(376,722)	-	(81,128)	(457,850)
	Total Federal Emergency Management Agency	<u>(376,722)</u>	<u>-</u>	<u>(81,128)</u>	<u>(457,850)</u>
	Total Federal Assistance	<u>\$ 172,118</u>	<u>\$ 2,738,951</u>	<u>\$ (2,917,377)</u>	<u>\$ (6,308)</u>

*Denotes a major program as defined by OMB Circular A-133.

The Schedule of Expenditures of Federal Awards is prepared on the accrual basis of accounting.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs Year Ended September 30, 2005

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, none of which were considered to be material weaknesses.
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 award programs was identified, which was not considered to be a material weakness.
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. The Authority's major programs are:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Environmental Protection Agency	66.418
Environmental Protection Agency	66.468
Environmental Protection Agency	66.600

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The Authority 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>
2005-01	Cash Management
2005-02	Exception in Meter Reading
2005-03	Federal Compliance Officer
2005-04	Procurement Documentation
2005-05	Internal Audit

Part III - Federal Award Findings and Questioned

<u>Reference Number</u>	<u>CFDA Number</u>	<u>Finding</u>	<u>Questioned Costs</u>
2005-01	66.418 66.468 66.600	Cash Management	\$ -

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-01
 CFDA No.: 66.418, 66.468, 66.600
 Program Name: Single Audit Funds
 Area: Cash Management
 Questioned Costs: \$0

Criteria: Per OMB A-133, the grantee should minimize the time elapsing between the transfer of Federal funds from the recipient and the pay out of funds for program purposes. In accordance with 31 CFR 205.12.b.(4), cash advance (pre-issuance or post-issuance) funding means that a Federal Program Agency transfers the actual amount of Federal funds to a State that will be paid out by the State, in a lump sum, not more than three business days prior to the day the State issues checks or initiates EFT payments.

Condition: We noted the following cash disbursements were disbursed more than three days from the time of grant receipt.

US Environmental Protection Agency					
CFDA No.	Program Title	Grant award	Check Clearance Date	Award Receipt Date	Interest Amount
66.418	Construction Grants For WWT Works	\$ 96,090	12/20/04	12/9/04	\$ 48
66.418	Construction Grants For WWT Works	112,584	2/23/05	2/16/05	31
66.418	Construction Grants For WWT Works	166,100	4/12/05	4/6/05	38
66.418	Construction Grants For WWT Works	212,379	5/9/05	5/3/05	52
66.418	Construction Grants For WWT Works	204,819	6/17/05	6/9/05	84
66.418	Construction Grants For WWT Works	136,789	7/29/05	7/19/05	87
66.418	Construction Grants For WWT Works	242,704	10/3/05	9/23/05	180
					<u>520</u>
66.468	Safe Drinking Water State Revolving Fund	124,200	8/25/05	8/18/05	48
66.600	Comprehensive Water Resources Master Plan - Phase I	461,320	10/4/05	9/15/05	758
66.600	Comprehensive Water Resources Master Plan - Phase I	219,406	10/31/05	9/15/05	314
					<u>1,072</u>
	Total				<u>\$ 1,640</u>

Cause: The underlying cause appears to be a combination of a lack of internal controls to ensure grant awards are disbursed three days upon receipt.

Effect: No known material effect on the financial statements results from this finding. However, noncompliance with the federal requirement may affect the entity's ability to receive future federal funds.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding No.: 2005-01, Continued
CFDA No.: 66.418, 66.468, 66.600
Program Name: Single Audit Funds
Area: Cash Management
Questioned Costs: \$0

Recommendation: Management should minimize the time elapsing between the transfer of Federal funds from the recipient and the pay out of funds in accordance with its program purposes and Federal requirements.

Auditee Response: GWA concurs with this finding and will take steps to ensure grant payments are disbursed on a timely basis.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2005

Finding Number 2005-02 – Exception in Meter Readings

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: In nineteen of seventy-six (25%) transactions tested, the readings were not comparable with previous and subsequent billings.

Cause: GWA had little to no control over ensuring adequate efforts were made by readers. Consequently, GWA cannot ensure exceptions are kept as low as possible. The Authority's Task Force is therefore overwhelmed with investigating a disproportionately large number of exceptions.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of the Guam Waterworks Authority.

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: GWA concurs with the comment. GWA is reluctant to hire a permanent clerk to assist in the review process when we believe the problem will be resolved through the automated meter reading project which will be completed by the end of calendar year 2006.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2005

Finding Number 2005-03 – Federal Compliance Administrator

Criteria: The Authority should consider establishing a Federal Compliance Administrator function, to perform, among other duties, check and review procedures on transaction processing, revenue protection, and ensuring adherence with federal requirements.

Condition: There are no checks and review procedures performed independently of a specific department to ensure adherence to Federal compliance requirements.

Cause: The Authority does not have a federal compliance administrator.

Effect: With the lack of Federal compliance administrator, the Authority faces a greater risk of loss, misuse of federal funds and a potential misstatement of account balances.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of the Guam Waterworks Authority.

Recommendation: The Authority should consider creating federal compliance administrator position.

Auditee Response: The Federal Compliance Officer is our Chief Engineer. The effort to increase operating costs is far beyond the purview of an audit. If there is an identified problem then something would need to be done.

Auditor's Response: If the Chief Engineer is also well versed in all federal procurement, reporting and documentation issues, then corrective action may not be necessary. We are aware that Guam Power Authority has vested this responsibility in a Finance/Accounting person and we recommend that the Authority consider whether that expertise may be shared.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding Number 2005-04 – Procurement Documentation

Criteria: Effort should be made to ensure the proper safekeeping of supporting documents.

Condition: The following supporting procurement documents could not be located.

A: No price quotations and proposals were obtained from other vendors:

<u>P.O. #</u>	<u>Amount</u>
260279	\$13,425
251105	34,180
261511	8,500
270023	11,945

B: The latest price quotations from different vendors were not obtained.

<u>P.O. #</u>	<u>Amount</u>
260992	\$ 8,400
261542	14,900
261543	14,900
261540	14,900
261547	14,900

C: The Authority appears to have a policy that requires CCU Board approval for purchases in excess of \$250,000. In one instance, such approval was not obtained. Additionally, in this instance, it appears that three Guam based informal bid solicitations occurred. Based on that data, a non-Guam based vendor was contacted and a contract was negotiated with that vendor.

Cause: There appears to be lack of internal control over safekeeping of accounting documents and a need to clarify procurement approvals required for significant purchases.

Effect: No known material effect on the financial statements results from this condition. However, the propriety of underlying account balances may be questioned. No questioned costs result from the above as all items relate to local funding.

Prior Year Status: The above condition is reiterative of conditions identified in the prior year audit of the Guam Waterworks Authority.

Recommendation: The Authority should ensure proper safekeeping of supporting documents, should clarify the role of the CCU in approving significant contracts, and should use its best efforts to ensure that all parties are included in bid solicitations at the same time.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2005

Finding Number 2005-04 – Supporting Documents, Continued

Auditee Response: With respect to Part A, GWA is continuing to address structural problems related to its procurement processes. With respect to Part B, GWA's buyers have been advised that they must obtain a separate quote for every procurement transaction. With respect to Part C, GWA believes it has a fiduciary duty to its ratepayers to ensure equipment is purchased at the lowest cost possible consistent with its laws, rules, and regulations. While there are provisions for off-island purchases, there are some inconsistencies and ambiguities in Guam's Procurement Law which leaves GWA open to bid protests with this type of purchase. GWA is exploring the use of Solicitations of Interest to help facilitate off-island purchases in a manner that would allow GWA to follow provisions of the procurement law that are less vulnerable to protests.

GUAM WATERWORKS AUTHORITY

Schedule of Findings and Questioned Costs, Continued Year Ended September 30, 2005

Finding Number 2005-05 – Internal Audit

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

Condition: There are no checks and review procedures performed independently of the specific department adherence to Standard Operating Procedures.

Cause: The Authority does not have an internal auditor in place to perform this function.

Effect: With the lack of an Internal Audit Department, the Authority faces a greater risk of loss, misuse of assets and a potential misstatement of account balances.

Prior Year: The above condition is reiterative of conditions identified in the prior year audit of the Guam Waterworks Authority.

Recommendation: The Authority should consider creating an Internal Audit department and should continue its efforts to avail itself of services of the Guam Power Authority internal audit department.

Auditee Response: The Internal Auditor function already exists and is being utilized.

Auditor's Response: We were unable to locate the existence of any internal audit work or reports connected with Guam Waterworks Authority.

GUAM WATERWORKS AUTHORITY

Resolution of Prior Year Findings and Questioned Costs
Year Ended September 30, 2005

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

Questioned Costs per the September 30, 2004 audit report	\$ 115,000
Questioned Costs per the September 30, 2005 audit report	<u> -</u>
Total unresolved questioned costs as of September 30, 2005	\$ <u>115,000</u>