PORT AUTHORITY OF GUAM

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND INTERNAL CONTROL

SEPTEMBER 30, 2001

Deloitte & Touche LLP
361 South Marine Drive
Tamuning, Guam 96913-3911

Tel: (671)646-3884
Fax: (671)649-4932
www.dttguam.com

Deloitte Touche Tohmatsu

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
Port Authority of Guam:

We have audited the financial statements of the Port Authority of Guam (the Authority) as of and for the year ended September 30, 2001, and have issued our report thereon dated October 25, 2002, which report was qualified due to our inability to obtain information to support the carrying value of inventories. 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.

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 01-1 though 01-6.

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 Board of Directors and management of the Port Authority 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.

Deloitte + Touche LLP

October 25, 2002

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Schedule of Findings and Questioned Costs
September 30, 2001

Finding Number 01-1 – Audit Adjustments

Criteria: Audit adjustments proposed by external auditors and approved by the Authority necessary to reconcile accounts to audit balances should be posted immediately upon issuance of the audit report or soon thereafter.

Condition: As of the beginning of the fiscal year 2001 audit (July 2002), several prior audit adjustments, accepted by the Authority, had not been posted to the Authority's records.

Cause: The cause of the original failure to record adjustments is unknown. However, as time passed and new officials were put in charge of coordinating the external audit, details of the audit corrections were lost and the Authority could not then accurately post adjustments to appropriate accounts.

Effect: Because the audit adjustments have not been recorded, management and the board of directors appear to have been using, for analysis and decision making purposes, internal financial information that differs materially from the audited financial statements.

Recommendation: Management should post all necessary audit adjustments. Management and a senior accounting staff member should be tasked with the annual posting of audit adjustments, which should occur immediately upon issuance of the annual audit report or soon thereafter. If past audit adjustments can no longer be understood or accounts no longer identified, the Authority should contact predecessor and current auditors for the details.

Auditee Response dated February 18, 2003: The Port Authority of Guam agrees with this finding. Some of the audit adjustments have no specific detail because they were unposted adjustments recommended by the predecessor auditor. It is difficult to make the entry if the account requires a specific vendor, customer or item number. This is basically the reason why the adjusting entries were not posted in a timely manner .

Management will make certain that the audit adjusting entries will be posted immediately. This will ensure that the internal financial statements that management and board of directors will be using for decision making are accurate.

Finding Number 01-2 – Inventory Schedule

Criteria: The Authority should maintain and update an inventory listing on a regular basis with quantities, unit costs and extensions, the total of which should agree with the inventory balance in the general ledger.

Condition: The Authority was unable to provide an inventory schedule with quantities, unit costs and accurately calculated extensions which agree with the balance recorded in the general ledger.

Cause: The cause for this condition is that the Authority's computer software cannot allow users to create an accurate inventory report.

Effect: We were unable to satisfy ourselves with respect to the recorded amount of inventory at September 30, 2001 and qualified our report accordingly.

Prior Year Status: This condition was also noted during the 1999 and 2000 audits.

Recommendation: The Authority should identify an inventory system which is able to produce the required reports.

Auditee Response dated January 7, 2003: The Port Authority of Guam agrees with this finding.

The auditors for FY1999, FY2000 and FY2001 observed and tested the items on the physical inventory for FY2000, FY2001 and FY2002. Reports were presented to them showing the variances of each item and corresponding adjusting entries in the inventory balances.

The JD Edwards system does not have a standard report showing the extended balances of each item and the grand total balance of the physical inventory, which can be compared to general ledger. This problem has been corrected in FY2002. The Information Technology division created a report that will have all the information needed to check the accuracy of the inventory balance against the general ledger account. Accounting has been requiring the supply section to do a cycle count of various items each month and to perform checks to see the physical count is the same as the JD Edwards system index card. These changes will ensure the integrity of this report in preparation for the physical inventory on September 30, 2002.

Finding Number 01-3 - Property - Surveyed Items

Criteria: Recorded property, plant and equipment (PP&E) should be promptly updated for items that are damaged beyond repair or that are obsolete. These items should be promptly removed from recorded asset classes and from depreciation listings.

Condition: The following item, which had been deemed beyond economical repair in April 2000 and was surveyed (possession transferred to General Services Agency) in February 2001, was still recorded on the September 30, 2001 asset listing:

Asset	Description	Cost	Accumulated Depreciation
393	5 Ton Hyster Forklift #92-96	$39,900	$38,902.50

Cause: The cause of this condition is an apparent oversight by the Authority during major revision of its property, plant and equipment subsidiary ledger in 2001.

Effect: No known material effect on the financial statements result from this condition.

Recommendation: The Authority should review its process for surveying equipment and should ensure a step or steps are included that require PP&E listings to be promptly updated for any changes to an item's status, such as usefulness, useful life or location.

Auditee Response dated February 18, 2003: The Port Authority agrees with this finding.

The Port will modify the process of surveying property, plant and equipments. Each section that request for equipments to be surveyed should forward the survey request to the controller for approval. Once the item has been physically surveyed, Accounting will do a disposal process in the Fixed Assets program. This procedure will do the corresponding journal entries and take the item off from the Fixed Assets Listing. Property Control Officer will review Fixed Assets listing monthly to verify if there are items that should have been disposed already.

Finding Number 01-4 – Lease Agreements

Criteria: All space lease contracts should be properly monitored to ensure all agreed-upon terms are followed by both parties.

Condition: Per review of a lease agreement effective since 1988, lease payments under the agreement should increase by ten percent (10%) each five-year period for as long as the agreement shall be in effect. However, since inception, lease billings have not increased.

Cause: Apparently, lack of personnel has prevented this lease agreement from being reviewed on an annual basis.

Effect: The Authority has lost lease income that it was entitled to. Lease income should have increased twice since the inception of the lease; however, the lease rate in 2001 is still $2,000, the same as it was in 1988.

Recommendation: We recommend that lease agreements be reviewed annually.

Auditee Response dated February 18, 2003: The Port agrees with this finding.

The rate for this lease agreement will be adjusted to the correct rate as of fiscal year 2003. Commercial division will be regularly reviewing the lease contracts of the tenants to make sure that any adjustments to the lease charges will be done in the correct time.

Finding Number 01-5 – Space Lease Income

Criteria: Lease agreements should be signed by both parties to confirm that the contract has been executed and considered binding.

Condition: Three (3) out of eighteen (18) lease agreements tested were not signed by both parties.

Cause: The cause of this condition is unknown.

Effect: Lease agreements may not be considered binding and parties may not be held accountable if default occurs.

Recommendation: We recommend that lease agreements be signed by both parties and be properly safeguarded.

Auditee Response dated February 18, 2003: The Port agrees with this finding.

The Port's commercial division will be reviewing all contracts of existing tenants and make sure that the contracts are signed by both parties.

Finding Number 01-6 – Property

Criteria: All major adjustments or reclassifications made by the Port to account balances should be properly documented and supported by explanatory schedules, letters or memos describing changes made and reasons therefor. Such documentation should be available upon request by management, directors or external auditors and should be filed and kept safe from loss or misplacement.

Condition: The effort undertaken by the Port in 2001 to improve property, plant and equipment (PP&E) records lacked the documentation described above. The two sections responsible for the effort, namely accounting and property control, apparently compared PP&E records, identified corrections to each, produced the necessary adjustments and reclassifications, and changed the records accordingly. However, documentation supporting the adjustments and reclassifications was not available for review.

Cause: The cause of this condition was insufficient coordination between the responsible sections, compounded by the Port's lack of familiarity with the new fixed assets system being used (JDEdwards).

Effect: The lack of proper documentation required us to incur time outside the scope of the audit to help the Port reconcile balances. Furthermore, our reconciliation showed that, before the audit adjustments that resulted, the Port's PP&E balances were materially misstated and could not be immediately corrected, due to the condition noted above. Therefore, management and directors may have used materially incorrect PP&E records for decision making purposes for several months during the year ended September 30, 2001.

Recommendation: The Port should ensure it implements proper planning and supervision when undertaking record improvement efforts coordinated between accounting and non-accounting departments. Staff level personnel involved should be properly instructed, guided and reviewed throughout the process, to insure that transactions are accurately recorded and adequately documented.

Auditee Response dated February 18, 2003: The Port Authority agrees with this finding.

The Fixed Assets listing that was presented to the predecessor auditor and the current auditor during the previous audits shows items in the old listing that are group together as one figure or improvements that has no description. When the Port was to go live on the JD Edwards Fixed Assets program, items should be properly identified and valued. Estimates was to be done to identify the different properties of the Port and a decision was made to use the Property Control Officers listing because those are the items that are accounted for. The cause is not the lack of familiarity to the fixed assets system, it is the insufficiency of the supporting documents.

The Port will ensure that all new assets and property improvements will be supported with proper documentation and it is regularly reconciled with the Property Control Officers fixed assets listing.

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Prior Years' Findings and Questioned Costs
September 30, 2001

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

Questioned Costs per the September 30, 1998 audit report	$ 39,322