Management Letter

Port Authority of Guam

For the year ended September 30, 2010

Ernst & Young

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December 30, 2010

The Management and Board of Directors
Port Authority of Guam
1026 Cabras Highway, Suite 201
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In planning and performing our audit of the financial statements of the Port Authority of Guam (the Authority) as of and for the year ended September 30, 2010, in accordance with auditing standards generally accepted in the United States, and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered its internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control.

A deficiency in internal control 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 material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control that we consider to be material weaknesses, as defined above.

Deficiency

We noted the following matter involving internal control over financial reporting and its operations that we consider to be a deficiency, as defined above.

Revisit Capitalization Policy

Observation:

During the audit of the Authority's construction-in-progress (CIP) accounts, it was noted that the following expenditures were capitalized into CIP, whereas they should have been expensed:

1. Gantry 3 Projects – Current year additions to CIP totaled approximately $1 million, of which approximately $700K pertains to normal repairs and maintenance relating to electrical, structural and corrosion prevention works.

<u>Deficiency, continued</u>

Revisit Capitalization Policy, continued

Observation, continued

We understand that the Gantry 3 project had not undergone a major overhaul/repair since its acquisition in 1992. The first maintenance project for the Gantry 3 started late 2007 to 2009, wherein expenditures incurred were capitalized. However, during fiscal year 2010, it was determined that expenditures incurred for Gantry 3 should be considered as part of normal repairs and maintenance and thus expensed. An adjustment was made to the financial statements to adjust the CIP to operating expense in the amount of $700K.

2. Port Modernization Plan – Current year additions to CIP totaled approximately $6 million, of which approximately $480K pertains to non-capitalizable professional services and travel expenses.

The Authority is currently undergoing Phase IA of its Port Modernization Program and is expected to incur significant capital expenditures throughout the process. Expenditures of an ancillary nature, such as professional services and technical studies should be reviewed to determine its proper accounting treatment. The cost of a capital asset should include only those ancillary charges necessary to place the capital asset into its intended location and condition for use.

Recommendation:

We recommend that the Authority revisit its existing capitalization policy to ensure the proper recognition of a capital asset versus an operating expenditure.

Management's Response

Management concurs to the recommendation of revisiting the Authority's existing capitalization policy to ensure recognition of a capital asset versus an operating expenditure. The refurbishment and overhaul projects for Gantry 3 started in late 2007 to 2010. In the beginning of each fiscal year, Matson submits a budget of expenditures under capital projects and operating expenses of repairs and maintenance related to Gantry 3. These expenditures were reviewed regularly with Matson if they are still part of the uncompleted projects. Matson maintenance staff has responded that these charges are related to the particular Gantry 3 capital improvement projects.

Management will make amendments to current capitalization policy to provide a better definition of what expenditures may be determined as a capital asset improvement and those that should be considered as regular operating expenses.

<u>Other Matters</u>:

We noted the following other matters during our audit:

Improve Controls on Annual and Sick Leave Process

Observation:

During pay period ending January 16, 2010, an employee requested and was granted approval for a 40 hour annual leave. However, based on the actual timesheet, an adjustment was made to record 3.5 hours of sick leave instead of annual leave. We were informed that the employee had insufficient annual leave balance. Accordingly, sick leave was used, although it was not properly supported and not in accordance with the Authority's employee handbook.

Recommendation:

The Authority's management should revisit its existing controls and should improve its implementation particularly on sick leave usage.

Management's Response:

Management concurs that it should improve in the implementation of controls on employee's annual and sick leave usage. Payroll staff will make sure that proper supporting documentation and approvals must be submitted before any adjustment is made to the employee's timesheet.

Revisit Emergency Procurement Requirements

Observation:

On July 3, 2003, the Authority entered into a Memorandum of Agreement (MOA) with a third party for equipment repair and maintenance services of its cargo lifting equipment. The MOA was negotiated under an emergency procurement and was valid for a period of thirty (30) days. The period has expired and repairs and maintenance services continue to be rendered based on this MOA.

Recommendation:

We recommend that since the emergency conditions of the July 3, 2003 MOA have been addressed, the Authority should undertake another bidding process to satisfy future repairs and maintenance on the related cargo lifting equipment.

<u>Other Matters, continued</u>:

Revisit Emergency Procurement Requirements, continued

Management's Response:

In March 2010, the Authority issued a competitive solicitation through a Request For Proposal (RFP) for the Performance Management Contract (PMC) for the Management of the Cargo Terminal Operations and Maintenance of the Cargo Handling Equipment. The contract was programmed to be awarded by end the of September 2010. It is the Authority's intent to terminate the MOA upon award of the PMC contract, since the scope of work includes the initial intent and the objectives of the MOA.

In August 2010, the RFP for the PMC was placed on stay procurement status as a result of an appeal. Pending resolution of the appeal, the Authority, in October 2010 has issued a notice to the provider terminating the MOA in its entirety effective January 31, 2011.

In anticipation of such resolution and in the interim, the Authority intends to provide in-house maintenance of the cargo handling equipment, as well as procurement of its parts and supplies.

Documentation on Procurement

Observation:

During our procurement testing, we noted that supporting documentation for the competitive solicitation of legal services, originally entered into beginning of 2006, was incomplete. Specifically, the Request for Proposal (RFP) checklist to evidence completeness of the file was lacking.

Recommendation:

During our inspection, we noted that the original proposal package, records of the advertisement of the proposal, records regarding the evaluation of proposers and the bid analysis were not included in the file. Guam procurement laws require that adequate documentation must be kept.

Management's Response:

For background, Port procurement staff was under the supervision of the Chief Procurement Officer of General Services Agency during the procurement process for legal services in 2007. As such, the procurement files are in the custody of General Services Agency and not the Port.

It is noted that a memorandum dated December 28, 2010 is in file which memorialized the lack of documentation and the events that occurred relating to the competitive solicitation of the legal services through RFP-07-001 in September 2006 which resulted to the execution of an agreement in June 2007.

Information System Control Review

We have separately reported in our letter dated December 30, 2010, addressed to the Authority's Board of Directors, certain information technology issues that we consider to be significant deficiencies under standards established by US 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.

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This communication is intended solely for the information and use of Management and the Board of Directors of the Authority, others within the organization, and the Office of Public Accountability, and is not intended to be and should not be used by anyone other than these specified parties. However, this report is also a matter of public record.

We would be pleased to discuss the above matters or to respond to any questions at your convenience.

Ernst & Young LLP