OFFICE OF THE PUBLIC AUDITOR

Guam Power Authority
FY 2008 Financial Highlights

April 20, 2009

The Guam Power Authority (GPA) ended fiscal year (FY) 2008 with an increase in net assets of $9.7 million (M) primarily due to the $13.5M payment received from the general fund for the unpaid streetlight bills that had accrued from 1997 through 2002. However, the credit crisis in the U.S. financial market has greatly affected GPA. GPA was unable to market its $20M short-term debt that had been renewed for nearly 10 years and the line of credit with Cathay Bank was fully drawn under the terms of the credit agreement. In November 2008, GPA's insurer's credit rating had been downgraded causing a default in the credit agreement. In March 2009, the default was cured as an amendment to the agreement had been negotiated with Cathay Bank wherein GPA will make principal payments of $5M plus interest at 7% per year to pay off the $20M outstanding loan in three years.

Deloitte and Touche LLP rendered an unqualified or "clean" opinion on the financial statements; however, four findings were identified in the Compliance and Internal Control report, one of which has been a material weakness since prior to 2002. A separate Management Letter was issued identifying 19 findings.

Effects of Rising Oil Prices

At first glance it would appear GPA had an increase in revenues of $64M, from $306.7M in 2007 to $370.6M in 2008. However, the Levelized Energy Adjustment Clause (LEAC)[1] allows GPA to recover its fuel costs. Fuel prices dramatically increased from a low of $46.58 per barrel in 2007 to a high of $120.35 per barrel in 2008, which correspondingly increased production fuel expenses by $62.3M, from $174.7M to $237.1M. This increase mainly contributed to the total increase of $65.8M in total production expenses from $191.3M to $257.1M. The remaining $3.5M increase in other production expenses was mainly attributed to an increase of salaries and wages of $1.9M.

Actual kilowatt sales were flat as customers of GPA are using less power to mitigate the impact of the rise in fuel charges, but GPA saw an increase in their customer base from 45,384 to 46,123.

Increase in Operating and Maintenance Expenses

In addition to the increase in fuel expenses, other operating and maintenance expenses increased by $3.3M. Increases were in transmission and distribution expenses of $1.7M ($8.5M to $10.3M); administrative and general expenses of $855,000 ($23M to $23.9M); and energy conversion costs of $606,000 ($18.3M to $18.9M). As a result, total operating and maintenance expenses were $340.3M in 2008 compared to $271.1M in 2007.

[1] An adjustable rate approved by the PUC on a bi-annual basis.

Cost of Living Allowance (COLA) Annuities Double

COLA/supplemental annuities doubled from $1M to $2M in 2008. The increase is mainly from medical and dental insurance for retirees, which was $529,000 in 2007 and $1.5M in 2008. Other expenses increased 140%, from $738,000 to $1.8M because of a write-off on capital assets deemed obsolete.

Cash Balances at Risk

As of September 30, 2008, GPA had bank balances of $64.8M, of which $50.3M were short-term investments administered by GPA's trustees and $10M was maintained in a financial institution subject to Federal Deposit Insurance Corporation (FDIC) insurance. However, of the $10M, $2.7M was FDIC insured.[2] As of September 30, 2008, $11.9M was exposed to custodial credit risk. Given the worldwide financial turmoil, GPA should maintain vigilance over its cash and investments.

Report on Compliance and Management Letter

Four significant deficiencies[3] were identified in the Report on Compliance and Internal Control, one of which remains a material weakness. This material weakness identified prior to FY 2002 pertains to GPA's inability to maintain detailed cost records for its property, plant, and equipment for $630M. GPA embarked on a plan to reconcile their books by December 31, 2009. The other three findings involved the following:

- Plant and Equipment being depreciated over extended useful lives resulting in a $1.8M adjustment by the auditor.
- Discrepancies in fuel inventory reports between the generation and the accounting department of $1.8M.
- Inability of software application program to produce accounts receivable subsidiary ledger reports.

In a separate management letter, 19 findings were noted compared to 15 in FY 2007. Of the 19 findings, eight were related to GPA's information technology system including the segregation of duties, user profiles and inappropriate access to sensitive system commands. The remaining 11 findings included:

- Independent reviews of payroll deductions not frequently performed;
- Updating of the fixed asset subsidiary ledgers and periodic inventories to verify the status and existence of assets not regularly performed;
- The lack of regular preparation and review of an inventory aging report; and
- Defective fuel auto gauges, which affect GPA's ability to ensure that movements of fuel are properly monitored to minimize losses.

For more details, refer to the Management Discussion and Analysis in the audit report.

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2 As of FY 2008, FDIC insurance was limited to $100,000, but has been increased to $250,000 in FY 2009.

3 A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects GPA's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles.