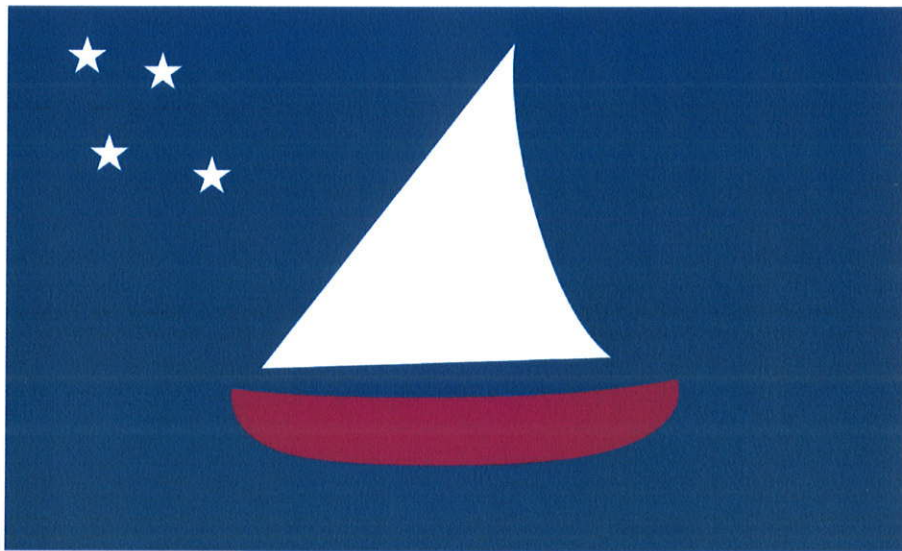




OFFICE OF THE PUBLIC AUDITOR
REPUBLIC OF PALAU

PERFORMANCE AUDIT REPORT

ON



SONSOROL STATE GOVERNMENT
REPUBLIC OF PALAU

PERIOD COVERED

OCTOBER 1, 2009 THROUGH SEPTEMBER 30, 2013

Performed by the Office of the Public Auditor

SON09-13-P06*opa00

REPUBLIC OF PALAU



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Office of the Public Auditor

November 2, 2016
Serial#: opa17-011au

Honorable Laura I. Miles
Governor
Sonsorol State Government
Office of the Governor
Koror, Republic of Palau

Subject: Final Report on the Performance Audit of Sonsorol State Government for the period October 1, 2009 through September 30, 2013.

Dear Governor Miles:

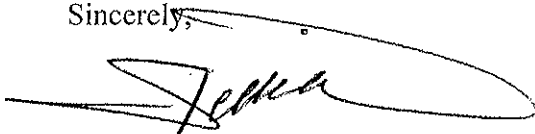
This report presents the result of our performance audit of Sonsorol State Government for the period from October 1, 2009 through September 30, 2013.

The Office of the Public Auditor (OPA) received your response to the Draft Audit Report. Based on the additional supporting documents provided, the OPA has made, where appropriate, revisions to the Draft Audit Report. The response (without the attachments) is published in verbatim in the Final Report.

The OPA has established an audit recommendation tracking system to keep track of the status of recommendations issued in this report. Accordingly, the OPA will conduct follow up inspections on your response and corrective action measures to assess their implementation and operation. On a semi-annual basis, June 30 and December 31 each year, the OPA will report the status of the recommendations to the Office of the President and Presiding Officers of the Olbiil Era Kelulau for their information and disposition.

If you have any questions regarding matters of audit findings and recommendations, the OPA will be available to discuss such matters at your request.

Sincerely,



Satrunino Tewid
Public Auditor
Republic of Palau

SONSOROL STATE GOVERNMENT
October 1, 2009 through September 30, 2013

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EXECUTIVE SUMMARY

November 2, 2016

Honorable Laura I. Miles
Governor
Sonsorol State Government
Koror, Republic of Palau

Dear Governor Miles:

This audit report presents the result of our audit of Sonsorol State Government covering fiscal years 2010 – 2013, October 1, 2009 through September 30, 2013.

The objective of the audit was to determine whether (1) expenditures were incurred in accordance with national and State laws and regulations, (2) revenues/cash receipts were properly deposited into the State Treasury, (3) expenditures and cash receipts were supported by adequate supporting documentation, (4) earmarked CIP grants were expended for purposes for which they were earmarked, and (5) the state has established proper internal controls to ensure that its properties are properly safeguarded and its transactions properly recorded.

As a result of the audit, the Office of the Public Auditor (OPA) found a number of weaknesses/deficiencies noted below relating to the administration of Sonsorol State funds, which we believe should be brought to the attention of management for appropriate corrective action. We also propose recommendation, which, if implemented, we believe will correct these weaknesses/deficiencies.

Specifically, our audit found that:

First, Sonsorol State did not take corrective action to implement audit recommendations and/or to resolve audit findings contained in the Office of the Public Auditor's (OPA) previous audit report covering fiscal years 2006 to 2009,

Second, the Governor and the Legislature did not coordinate and collaborate to ensure that the State's unified, continuing resolution and supplemental budgets were timely adopted,

Third, the finance staff did not receive appropriate trainings on the operation of the QuickBooks Accounts Payable module to properly record and keep track of accounts payable,

Fourth, the Governor did not monitor the finance staff to ensure that bank reconciliations were being performed,

Fifth, the Governor did not comply with the Republic of Palau's (ROP) Procurement Law and Regulations by procuring goods and services costing \$5,000 or greater without competitive bidding,

Sixth, the finance staff did not receive appropriate trainings on the operation of the QuickBooks Fixed Asset module to properly record and keep track of fixed asset purchases and disposals,

Seventh, the State's Personnel System has not been fully implemented to ensure that all control elements of the system are operating as intended,

Eighth, state employees traveled with state funds and failed to file the required travel vouchers to justify the use of funds,

Ninth, the Governor failed to execute a contract to justify payments for legal services,

Tenth, the Governor failed to review expenditures to ensure that their classifications were in accordance with the State's appropriation budget,

Eleventh, there were no controls in place to ensure that expenditures for youth programs contain adequate supporting documents to substantiate the use of funds,

Twelfth, the Governor did not ensure that a contract for professional services was certified for funds availability and approved before the provision of services,

Thirteenth, the Governor failed to enforce controls over disbursements to ensure that expenditures contain adequate supporting documents.

Recommendations

To correct the above weaknesses/deficiencies, the OPA recommends that Sonsorol State Government implements the following recommendations:

First, we recommend the Governor take affirmative action by implementing the corrective action plans contained in the OPA's prior year's audit report,

Second, we recommend the Governor and the Legislature coordinate and collaborate in enacting the State's Budget Laws (unified, supplemental, continuing resolution budgets) to ensure their timely adoption,

Third, the State Treasury has recently received extensive training on the operation of the QuickBooks accounting system, which we recommend the Governor encourage the staff to use the system to record and keep track of accounts payable and related obligations,

Fourth, the Governor directs the State treasurer to use the QuickBooks accounting system to perform bank reconciliation,

Fifth, the Governor adheres to the Republic of Palau's Procurement Law and Regulations when making purchases equal to or greater than \$5,000,

Sixth, the Governor directs the State Treasurer to use the QuickBooks accounting system to record and update the State's fixed assets,

Seventh, the Governor enforces and monitors the personnel system to ensure that all components of the system and related controls are properly implemented,

Eighth, the Governor strictly enforces the State's Travel Policy by requiring travelers to file travel vouchers to justify the use of State funds for travel,

Office of the Public Auditor

Ninth, the Governor executes a contract that spells out the terms and conditions of legal services to be provided to the State,

Tenth, the Governor reviews expenditures to ensure that their classifications are in accordance with the State's appropriation budget,


Eleventh, the Governor directs the State Treasurer to review expenditures to ensure they contain the proper supporting documents,

Twelfth, the Governor ensures that contracts for professional services are certified for funds availability and approved before the provision of services,

Thirteenth, the Governor establishes and implements controls over cash disbursements to ensure they contain the proper supporting documents.

Finally, the Office of the Public Auditor would like to thank the staff and management of Sonora State Government for the professional courtesy and cooperation extended to us during the audit.

Sincerely,



Satrunino Tewid
Public Auditor

BACKGROUND

Sonsorol State is one of the sixteen (16) States in the Republic of Palau. The State's Constitution, ratified on October 10, 1983, creates the constitutional government of the State ofonsorol. The Constitution established the primary branches of the government consisting of the Executive (Office of the Governor), the Council of Chiefs, and the Legislature.

The Governor shall be the Chief Executive of the State Government. The Governor shall have the power to enforce the laws of the State, to spend money pursuant to appropriation laws, to collect taxes, and to propose an annual unified budget for the State Government, among other duties and responsibilities. The Governor and Lieutenant Governor shall be elected in a statewide election for terms of four years and shall not serve more than two consecutive terms.

The Council of Chiefs is composed of each of the traditional Paramount Chiefs from the islands ofonsorol State. The Council of Chiefs shall have the following functions and powers: to request the Governor to veto any bill affecting customary law, traditional practices..., to participate in negotiations with other states or foreign companies, to select one chief from its membership to serve in the National Council of Chiefs for a term of four years..., among other powers.

The Legislative power ofonsorol State shall be vested in theonsorol State Legislature which shall consist of one house. The Legislature shall be composed of four Paramount Chiefs from the four Municipalities inonsorol State..., two legislators to be popularly elected at-large and, for the first eight years after the effective date of the constitution, four representatives shall be popularly elected from the four Municipalities as follows: a) one shall be elected fromonsorol Municipality; b) one shall be elected from Pulo Anna Municipality; c) one shall be elected from Merir Municipality; and d) one shall be elected from Fana Municipality... The legislature shall have the following powers: to levy taxes which shall be uniformly applied throughout the state, to borrow money on the credit of the State..., to delegate authority to municipalities and their administrative office, to enact laws..., to provide for the welfare, peace and security of State residents, among other powers.

Compensation for the Governor and Lieutenant Governor, Council of Chiefs, and the State Legislature shall be established by law.

Article XII, Section 1, of the State's Constitution states in part: "There shall be a State treasury and municipal treasuries for each of the municipalities within the State. All public revenues from whatever source derived shall be deposited in the appropriate treasury. No funds shall be withdrawn from any treasury except by law."

In addition, Article XII, Section 12, of the State's Constitution states: "The State Legislature shall request an auditor to audit the State Budget at least once every four years and not later than 18 months after the effective date of this constitution. The auditor shall audit the accounts of every branch and agency of the State Government as well as advise the government of proper financial management techniques..."

The major source of funding for state operation comes from the Olbill Era Kelulau (OEK) appropriation in the form of block grants and capital improvement projects. For fiscal year 2010 through 2013, the OEK appropriated the sum of \$690,025 in block grants which includes only \$5,000 for capital improvement projects relating to transportation expenses.

OBJECTIVE, SCOPE AND METHODOLOGY

The objective of the audit was to determine whether (1) expenditures were incurred in accordance with National and State laws and regulations, (2) cash receipts were properly deposited into the state treasury, (3) expenditures and cash receipts were supported by adequate supporting documentation, (4) earmarked CIP grants were expended for purposes for which they were authorized and appropriated, and (5) the state had established proper internal controls to ensure proper safeguarding of its properties and transactions were properly recorded.

The audit covered the period from fiscal year beginning October 1, 2009 through September 30, 2013. As this is the performance audit, we did not conduct audit procedures to assess the fairness of the financial statements of the State or any component or accounts within those financial statements and therefore express no opinion on the financial statements.

We conducted this performance audit in accordance with the generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions

Office of the Public Auditor

based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The Public Auditing Act of 1985 empowers the Office of the Public Auditor to specifically act to prevent fraud, waste, and abuse in the collection and expenditure of public funds. The Public Auditor may make recommendations on the prevention and/or detection of fraud, waste, and abuse of public funds.

To accomplish our audit objective, we reviewed bank reconciliations, earmarked CIP funds, accounts receivable and accounts payable, fixed assets, cash receipts, and non-payroll and payroll expenditures. In performing the review, we conducted specific tests of the aforementioned components of the State's accounting system and procedures to assess the adequacy of the State's system of internal controls. The audit involved reviewing accounting records maintained by the State as well as on-site inspection of the State's fixed assets. We also interviewed appropriate state officials and reviewed relevant accounting records maintained at the Bureau of National Treasury.

FINDINGS AND RECOMMENDATIONS

Finding No. 1: Outstanding Prior Year Audit Findings and Recommendations

Sonsorol State should comply with 5 PNCA §401 by implementing audit recommendations contained in the Office of the Public Auditor's (OPA) prior year's audit reports.

Sonsorol State has not taken affirmative action to implement corrective action plan and/or to resolve audit findings contained in the OPA's previous audit reports covering fiscal years 2006 through 2009 as follows:

- Accounts Payable System
- Bank Reconciliations
- Procurement lacked competitive bidding
- Fixed Asset Accounting System
- Personnel System
- Travel Vouchers not filed to justify the travel cost
- Uncategorized Expenditures
- Disbursement Lack Supporting Documentation

The Governor responded to the prior year audit report by providing corrective action plans; however, the plans have yet to be implemented.

Sonsorol State's failure to take affirmative action to comply with prior year's audit recommendations by the OPA constitutes non-compliance with 5 PNCA §401, which may result in the suspension of the State's block grants.

Recommendation: We recommend the Governor takes affirmative action by implementing the corrective action plans contained in the response to the prior year's audit report. Doing so will strengthen internal controls over State operations and prevent possible future suspension of State's block grants.

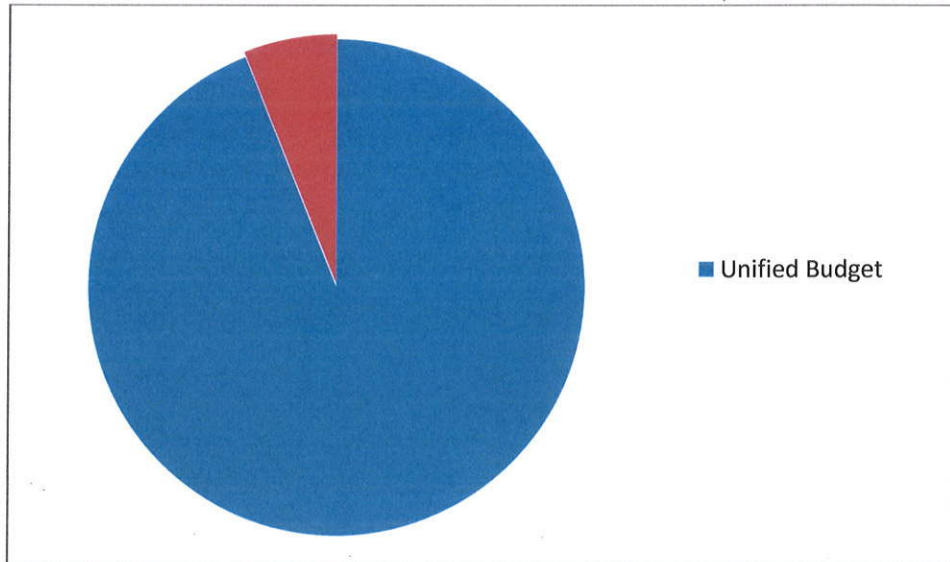
Auditee's Response: *The Sonsorol State did not provide a response to this specific finding; but responded to findings Nos. 2 to 15 a shown below.*

Finding No. 2: State Budgets

Article XII Section 1 of the State’s Constitution states “There shall be a State Treasury and municipal treasuries for each of the municipalities within Sonsorol State. No funds shall be withdrawn from any treasury except by law.” In addition, proper coordination and collaboration between the Office of the Governor and the Legislature is critical in enacting a supplemental budget to ensure sufficient time for planning and executing the budget.

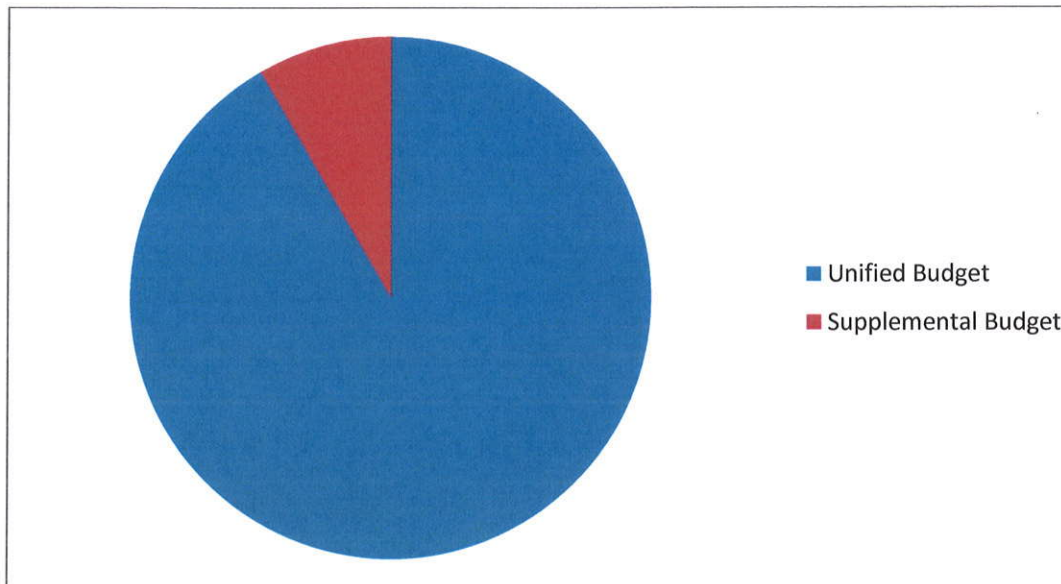
During the audit we reviewed State budgets for each fiscal year from 2010 to 2013 and found the following:

The unified budget for fiscal year 2010 was approved on October 29, 2009 in the amount of \$209,521. On September 30, 2010, the state approved a supplemental budget for \$13,575, giving the Governor only one (1) day to execute the budget, as funds lapse on September 30, as illustrated in the Chart below:



For the 2010 Unified Budget, the Governor had nearly the entire fiscal year to plan and expend \$209,521; in contrast, the Governor was given only one (1) day to plan and expend the \$13,575 supplemental funding.

The unified budget for fiscal year 2011 was approved on March 15, 2011 in the amount of \$187,858. On September 26, 2011, the state approved a supplemental budget for \$17,200, with only five days to spend the supplemental budget before the fiscal year ends, as shown in the chart below:



With respect to fiscal year 2012, the State did not have a budget authority from April 1 through April 26, 2012, yet it expended \$13,114.

Furthermore, the following budget acts were approved in fiscal year 2013:

- Continuing Resolution for the first and second quarter in the amount of \$ 98,900
- Continuing Resolution for April 2013 in the amount of \$ 13,674
- Continuing Resolution for May and June in the amount of \$ 29,397
- Continuing Resolution for the last quarter in the amount of \$ 39,344
- Unified Budget in the amount of \$ 242,754.15 was approved on 9/28/13

Therefore, the sum of \$181,315 were authorized and appropriated under four (4) separate Continuing Resolutions as State budget until September 28, 2013 when the State passed a Unified Annual budget for fiscal year 2013 in the amount of \$242,754.15. Under these conditions, the State had only three days to operate and execute the unified budget for fiscal year 2013.

The Office of the Governor and the Legislature did not coordinate and work together to ensure that the state unified and supplemental budgets were timely approved and provided adequate working time to plan and execute expenditures.

As a result, the Governor was not provided sufficient time with which to plan and execute expenditures more effectively and efficiently. In addition, the Governor may have expended \$13,114 of State funds during the period April 1 through April 26, 2012 without any budget authority in violation of the State's Constitution.

Recommendation: We recommend the Governor and the State Legislature coordinate and collaborate in the process of enacting State Budget laws, it be a unified or a supplemental budget, to ensure the timely approval of the budget and the availability of funds to plan and execute expenditures more effectively and efficiently.

Auditee's Response: *The office of the Governor is working closely with the Sponsorol State Legislature with respect to State Budget Bills. For FY 2016 the State Unified Budget was enacted on Dec. 31, 2015. The first Supplemental Budget was enacted April 11, 2016. Due to additional State needs and new projects a Second Supplemental Budget Bill has been submitted to the State Legislature and is being deliberated on at the current special session. Both offices will continue to work together to make sure that the state budgets are enacted on a timely basis giving the executive office enough time to plan and execute services.*

OPA's Comments: We commend the Office of the Governor and the State Legislature for working together to ensure that State Budgets are timely enacted to provide the Governor sufficient time to plan and execute expenditures. Subsequent audits will be conducted to determine if the cooperative efforts continue in the years ahead.

Finding No. 3: Accounts Payable System

A sound system of internal control dictates that an accounts payable accounting system is essential to account for and keep track of accounts payable and other obligations of the State.

During the audit we found that the State has established a system (QuickBooks Accounting System) to record accounts payable; however, the system is not used to its potential to ensure the accuracy of accounts payable. We were informed by the Treasurer that the State uses the QuickBooks accounting system to record and keep track of accounts payable. We reviewed the accounts payable recorded on the QuickBooks balance sheet, the subsidiary ledgers and the listing provided by the State and the amounts were all different and did not reconcile. In addition, the financial statements provided by the Governor to the Legislature at the end of fiscal year 2013 did not include amount for accounts payable.

The cause of the above condition is that the State finance staff did not receive the proper training on the operation of the QuickBooks Accounts Payable module.

As a result, the state's accounts payable is inaccurate and could lead to potential misstatement of accounts payable on the financial statements. In addition, the state is unable to effectively monitor and prioritize payment of its obligations to minimize interest charges and penalties associated with late payment. Furthermore, inaccurate accounts payable could lead to the use of inaccurate information in preparing the State budget, resulting in an inaccurate budget law.

Recommendation: In 2015 and 2016 the State Treasury staff received extensive training on the operation of the QuickBooks accounting system, including a module on accounting for accounts payable. We recommend that the Governor encourage the staff to use the system to further improve and enhance the State's accounting system, including accounts payable and related obligations. The use of the QuickBooks accounting system is essential as it would prepare the State to produce financial statements to support the annual financial audits of the State pursuant to RPPL No. 9-9.

Auditee's Response: *This is the same weakness the State had with the Prior Years Oct – Sep 2009 Audit Finding No. 8. Two things have happened since that finding which have helped establish the State's Accounts Payable System. 1) Hiring of the State Accountant who has command of the Quickbooks software. She also has had a good number of years experience with accounting. 2) The training sessions offered by your office for all the state treasurers have helped our treasurer in developing the system which is being updated regularly. Today the State's Accounts Payable System is up-to-date. Accounts Payable summary report is attached for your reference.*

OPA's Comments: The OPA commends the Governor for taking corrective action to resolve this finding, which, as a result, can potentially resolve other findings related to the State's accounting system. The hiring of an Accountant and training of State's finance staff on the use of the QuickBooks accounting system sets the stage for the State to continue to improve its accounting system and the skills of its finance staff and, at the same time, prepare the State for annual financial audits required by RPPL No. 9-9.

Finding No. 4: Bank Reconciliations

Effective cash management requires that monthly bank reconciliation should be performed to establish a reliable and accurate system to account for and monitor the State's cash activities.

Our audit revealed that the State did not perform monthly bank reconciliation of its bank accounts for fiscal years 2010 through 2013.

This is due in part to the fact that the State finance staff did not receive the proper training on the use of QuickBooks accounting system to perform bank reconciliation. In addition, management is not monitoring the financial operations of the State to ensure that essential internal control functions (bank reconciliation) are being performed.

The absence of bank reconciliation can lead to recording errors and other irregularities affecting cash balances without timely detection. Without timely detection, the State may carry an inaccurate balance on its account, which may lead to the issuance of checks from an account with insufficient funds and incurring overdraft charges. In addition, without bank reconciliation, cash balance is susceptible to misstatement on the financial statements.

Recommendation: The State has recently received extensive training on bank reconciliation using the QuickBooks accounting system. We recommend the Governor encourage the State Finance office to use the accounting system to perform bank reconciliation. On a monthly basis, the Treasurer should reconcile the balance of cash per the State's records (checking account) to the balance per bank. The reconciliation process would enable the State to identify errors and other irregularities and adjust State records accordingly. In addition, bank reconciliation enhances the State's ability to maintain accurate cash balances to prevent bank overdraft charges and report accurate cash balance on its financial statements.

Auditee's Response: *This is the same weakness with the State Treasury as was reported in Oct 2005-Sep 2009 Audit Finding No. 10. Presently, the State Treasury is utilizing Quickbooks with Bank Reconciliation for years 2013 to the present. Prior years' bank reconciliation will be reported separately. The attached summary report will reveal the State's effort towards resolving this long standing problem with the State's Treasury. The State Treasury will continue its effort to resolve its financial reporting weaknesses.*

OPA's Comments: The OPA commends the Governor for taking corrective action to resolve this finding on bank reconciliation, which, as a result, can potentially resolve other findings related

to the State’s accounting system. The hiring of an Accountant and training of State’s finance staff on the use of the QuickBooks accounting system sets the stage for the State to continue to improve its accounting system and the skills of its finance staff and, at the same time, prepare the State for annual financial audits required by RPPL No. 9-9.

Finding No. 5: Competitive Bidding

40 PNCA § 625 (b) requires that any purchases by the State Government greater or equal to \$5,000 shall be subject to competitive bidding.

During the audit we found that the State procured fuel and boat charters the value of which exceeded \$5,000 without competitive bidding. Details of expenditures are shown below:

Check Date	Check No.	Amount	Vendor	Description
10/13/10	11691	\$ 5,600.00	Impac Tours	Co-share of Charter Fee
1/17/12	12511	6,996.00	Blue Bay Petroleum Inc.	Diesel
5/21/12	12727	4,500.00	Impac Tours	Sea Bird Charter
5/24/12	12730	4,500.00	Impac Tours	Sea Bird Charter
5/30/12	12746	3,000.00	Impac Tours	Field Trip Charter
	Totals	\$24,596.00		

The Governor did not follow the Republic of Palau’s Procurement Law and Regulations in the procurement of the above goods and services.

As a result, we were unable to determine if the State obtained the lowest price or best value for the above products and services.

Recommendation: We recommend the Governor adheres to the Republic of Palau’s Procurement Law and Regulations by ensuring that State procurements greater or equal to \$5,000 are subject to competitive bidding. In addition, we recommend the Office of the Attorney General or the office of the Special Prosecutor investigate the above procurements and take appropriate action for violation of the Procurement Law and Regulations.

Auditee’s Response: *The Office of the Governor has taken the effort to comply with Palau’s Procurement Law and Regulations. We have begun making out bid announcements conscientiously. Expenditures under this finding came about during the time Sonsorol State and Hatohobei State were conducting combined field trips thereby both states co-shared trip fuel*

and boat charter expenses. Co-sharing caused some confusion as to which State conducts the bidding process, and which State drafts and gets a contract signed. Attached is a copy of the contract with Impact Tours which involves payment through check number 11691 dated 10/13/10 in the amount of \$5,600. Attached also is a copy of contract signed between Impact Tours and Sonsorol State dated 5/21/12. This contract involves check numbers 12727, 12730, and 12746. The complete charter cost for this trip was \$19,000 which was shared with EQPB. Lastly, we contacted Blue Bay Petroleum Inc. regarding a copy of Check No. 12511 - \$6,996 and any other supporting documents they may have for the check but unfortunately they were not able to provide for us.

OPA's Comments: The OPA will be monitoring State's procurements to determine whether the State is complying with the ROP Procurement Law and Regulations, non-compliance with which could result in Questioned Costs and withholding of State's block grants.

Finding No. 6: Fixed Asset Accounting System

A fixed asset accounting system is essential to properly account for the acquisition and disposal of fixed assets. Furthermore, policies and procedures are essential to identify State properties, conduct periodic physical inventory and inspection, and to safeguard fixed assets.

We found deficiencies in the way the State was accounting for and monitoring its fixed assets. For example, we were not able to determine the value of the ICOM Radio as the invoice provided was a quote only. In addition, assets such as a cooler, a blackberry cell phone, and an Asus 15" notebook were still in the possession of the former Governor and we were not able to physically observe the items to determine their existence and condition.

The cause of this condition is lack of monitoring and conducting physical inventory to identify, locate and reconcile the inventory to State records. In addition, the Governor should pursue and take legal action, if necessary, to recover those assets that are still in the custody of the former Governor as these are government properties. Finally, invoices and other records should be retained and filed to support fixed asset purchases such as costs, date of purchase, vendor and other information.

As a result, we were not able to determine the existence, value, condition and location of some of the State's fixed assets.

Recommendation: We recommend that the Governor take appropriate action to recover the State properties from the former governor. In addition, the State finance staff recently received extensive training on the QuickBooks Accounting system and should be encouraged to use the system to improve the accounting functions of the State, including the recording of fixed assets. Moreover, the Treasurer should periodically review fixed asset records to ensure they contain the proper supporting documents (invoices, donation documents, etc.) to substantiate fixed asset purchases. Finally, on an annual basis, the Governor should direct the Finance staff to conduct physical inventory of fixed assets to determine their location, condition and reconcile the inventory to State records.

Auditee's Response: *Sonsorol State Treasury has developed its Fixed Asset Accounting System and continues to update as recommended. An inventory report is attached for your perusal. A copy of letter sent to former Governor Yangilmau for retrieval of State properties is also attached.*

OPA's Comments: The OPA commends the Governor for taking corrective action to resolve this finding, which, as a result, can potentially resolve other findings related to the State's accounting system. The hiring of an Accountant and training of State's finance staff on the use of the QuickBooks accounting system sets the stage for the State to continue to improve its accounting system and the skills of its finance staff and, at the same time, prepare the State for annual financial audits required by RPPL No. 9-9. The State should continue the efforts to recover the State properties from the former Governor.

Finding No. 7: Personnel System

A sound system of internal control dictates that the State maintains personnel files for each employee which contain, at a minimum, employment application, a personnel action form, employment contract, allotment forms, evaluations, disciplinary actions, and etc.

The audit revealed several weaknesses in the State's personnel system. For example, we found that some personnel files were missing essential documents such as employment contract, personnel action form, allotment form, etc. These documents are essential as they are source documents to support authorized pay level/rate and employee allotment.

The Governor did not monitor and enforce the personnel system to ensure that all components of the system are operating as intended.

As a result, we questioned the following payroll expenditures for each fiscal year noted:

Fiscal Years	Amount
2010	\$ 100.00
2011	225.00
2012	1,482.00
2013	500.00
Total	\$ 2,307.00

Recommendation: We recommend that the Governor enforce and monitor the personnel system to ensure that all components of the system and related controls are operating effectively, including properly authorized Personnel Action Forms (PAF) for all employees. In addition, we recommend that the State Treasurer periodically reviews employee personnel files to ensure each file contain the following documents: a Personnel Action Form, contract (if any), allotment authorization, and other applicable personnel action documents. Moreover, the Treasurer should be more attentive when processing personnel documents to ensure that all documents are properly signed and approved by the Governor and the employee, as appropriate.

Auditee's Response: *Finding No. 8 is identical with Finding No. 7 for Audit Report Oct 2005 – Sep 2009. State personnel Filing System has taken some time to get developed and updated to comply with the recommendations stated in prior years' audit report and this current one. However, the State Treasury has taken big steps towards improvement of its system so that today Personnel Action Forms for employees are in place, contracts are signed and kept in file, allotment authorizations are signed and authorized and kept in employee's personnel files. Attached is a summary report of the Treasury's personnel filing system.*

We continue to refine the personnel system. One way we ensure updated personnel file is having the State Treasury take on Municipal payroll similar to the National Treasury performing state's payroll. Additionally we have mandated the receipt of Individual timesheets of employees residing on the islands at every field trips. We are also looking into color coding and numbering our forms to differentiate State vs. Municipal employees.

Please review the enclosed report on the disbursement under this finding.

OPA's Comments: The OPA commends the Governor for taking corrective action to implement the Personnel System for the State. The Personnel System ensures transparency and accountability over payroll expenditures by ensuring that each employee's personnel file

contains the proper supporting documents to support payroll expenditures. The OPA will continue to monitor the corrective measures to determine their proper implementation and sustainability.

Finding No. 8: Travel Vouchers

Travel Policies and Procedures provide important guidelines on how State funds are used to fund official travel including Travel Authorizations, per diem rates of travel destination, authorized travel expenses, trip reports, and filing travel vouchers after completion of travel.

The audit revealed that \$4,614 of State funds were used for travel; however, travelers failed to file the required travel vouchers after completion of travel. The filing of travel voucher (with related supporting documents such as invoices/receipts) is essential as it documents the purpose of travel, expenses authorized and incurred for trip and justifies the use of public funds.

The Governor did not enforce the travel policies to ensure that travelers file their travel vouchers with the proper supporting documents such as invoices/receipts, ticket copies, trip reports, etc. after completion of travel.

Due to lack of travel vouchers, we were unable to determine the propriety of travel expenditures and whether the purpose of travel was accomplished.

Recommendation: We recommend the Governor strictly enforce the State Travel Policies by requiring travelers to file travel vouchers after completion of travel. A travel voucher (consisting of a Travel Authorization, invoices/receipts, ticket stubs, boarding passes, trip report, etc.) should be filed within thirty (30) days after completion of travel. A traveler who fails to file a travel voucher within the required filing period should have the cost of travel garnished from his/her pay on a bi-weekly basis. In addition, an official who fails to file a travel voucher should be prohibited from further travel until he/she fulfills the filing requirements.

Auditee's Response: *Finding No. 9 is identical to Finding No. 4 in the Audit Report Oct 2005 – Sep 2009. Travel policies were loosely practiced in the past. The State Treasury in 2014 attended training on Procurement Policies and the Executive Travel Policies conducted by the National Government. The Treasurer is now aware and is capable of complying with these policies. The Treasurer has developed travel voucher forms based on the Executive Travel*

Policies for all state future travels. The Treasurer has made efforts to collect supporting documents from the travelers. She has received some but not all. Attached are some of those documents received as well as the state travel voucher form.

OPA's Comments: The OPA commends the Governor for implementing the Travel Policies and Procedures. The policies and procedures, like other State policies, ensure that public funds used for official travel are properly documented to justify travel expenditures. The OPA will continue to monitor the corrective measures to determine their proper implementation and sustainability.

Finding No. 9: Legal Services

A sound system of internal control requires that when procuring professional services the State should enter into a formal written agreement. The agreement should specify the nature of services to be rendered, billing rates, methods of billing and payment, and other terms and conditions.

The audit revealed that the State paid for legal services to several attorneys at a local law firm without a contract spelling out the terms and conditions of the agreement such as the nature of services to be rendered, billing rate, method of billing and payment, etc. In addition, some of the billings and invoices did not specify in detail the nature of services rendered to enable us to determine if the services were for the benefit or interest of the State. Provided below is a schedule of payments for legal services.

Check Date	Check No.	Amount
10/26/09	10957	\$ 1,000
6/2/10	11418	1,000
3/12/12	12608	970
7/22/13	13497	500
	Total	\$ 3,470

The cause of the above condition is failure of the Governor to execute a contract for legal services that spells out the terms and conditions of the agreement such as the nature of services to be rendered, billing rate, method of billing and payment, etc. In addition, the lack of details justifying the nature of services rendered makes it difficult to determine how the services benefited or served the interest of the State.

Without a written agreement and detailed justification for the services rendered, we questioned the entire amount of \$3,470 as to how it benefited or served the interest of the State.

Recommendation: We recommend that in the procurement of professional services the Governor enter into a contract that spells out the terms and conditions of the agreement such as nature of services to be rendered, billing rate, method of billing and payment, etc. In addition, in accepting and paying for services rendered, the Governor should instruct the attorney to specify in detail (billing) the nature of services rendered to justify how these services benefited or served the interest of the State.

Auditee's Response: *The current legal services with the State has a formal written agreement specifying nature of services, billing rate, method of payment, etc.*

We have attached supporting documents for this finding.

OPA's Comments: The OPA commends the Governor for taking corrective action to resolve this finding. In addition to the contract, the Governor should instruct its legal counsel to specify in each billing statement the time spent on each type of service provided (legal research, preparing letters, drafting legislation, etc.) to justify the total amount paid.

Finding No. 10: Uncategorized Expenditures

Article XII, Section 1, of the State's Constitution states in part: "There shall be a State treasury and municipal treasuries for each of the municipalities within Sonora State. All public revenues from whatever source derived shall be deposited in the appropriate treasury. *No funds shall be withdrawn from any treasury except by law.*"

The State Public Laws SSPL No. 7-6R-1, SSPL No. 7-11R-1, SSPL No. 7-7S-1, and SSPL No. 8-10S-1 appropriated funds to cover State operations for fiscal years 2010 through 2013. Based on our review of these appropriations laws, we found no budget activity or line item "uncategorized expenditures". However, during the audit we found that on numerous occasions the State expended funds and charged expenditures to a category captioned "uncategorized expenditures" in the fiscal years shown below:

Fiscal Year	Amount
2010	\$ 11,442
2011	7,600
2012	475
2013	1,750
Total	\$ 21,267

The cause of the above condition is that the Governor is not reviewing Quarterly, Semi-Annual, and Annual expenditure reports to ensure that expenditures classification coincide with the State's appropriation budget.

As a result, the \$11,442 expended in fiscal year 2010, \$7,600 expended in fiscal year 2011, \$475 expended in fiscal year 2012, and \$1,750 expended in fiscal year 2013 may be in violation of the State's Constitution as they were not properly authorized by law.

Recommendation: We recommend the Governor direct the State Treasurer to record and classify expenditures in accordance with the State's unified budget acts. Furthermore, the Treasurer should be more careful in preparing disbursement documents (APV, PO, RQ, etc.) to ensure the documents identify the correct account (budget activity) to be charged, and the Governor should not approve procurement documents unless there are sufficient funds in the account to cover the expenditures. Moreover, the Governor should review Quarterly, Semi-annual, and Annual expenditures reports to ensure expenditures classification coincides with the State's unified budget.

Auditee's Response: *Cause of the Un-categorized expenditures is the same as that stated in Finding No. 3 of this report. All expenditures that were new or not classified in the budget act were maintained and reported under the uncategorized classification. Three obvious errors found in these positings: 1) prior year payables were posted in Uncategorized Account; 2) the expenditures has budget but Classification entered corrected; 3) posting error. But, since the hiring of an accountant in 2014 the State Treasury had made big improvements with our accounting system. The accountant has set up the accounting system with Quickbooks with the books coinciding with the budget classifications specified in the state budget act. The attached report will clarify the three posting issues as mentioned above. Copy of the journal entry is also attached for reference.*

OPA's Comments: All expenditures should have a matching budget line item in the State budget, except for payment of prior year obligations; otherwise, it would be an illegal expenditure.

We commend the Governor for taking corrective action to correct this finding. The Governor should continue to work with the State Treasurer to refine the accuracy of expenditures classification and the Office of the Public Auditor will continue to provide the required assistance to further improve the system.

Finding No. 11: Youth Programs

A sound system of internal control dictates that expenditure of funds should contain proper supporting documents to justify the purpose of the expenditure; the amount (cost and quantities) of goods and services purchased, and the recording of transactions in the accounting system.

Our audit revealed that the following checks were disbursed to the State Youth without supporting documents to substantiate that the funds were used for Youth programs.

Check Date:	Check No.	Amount
3/10/10	11245	\$ 500.00
9/29/10	11656	1,000.00
9/28/11	12312	200.00
	Total	\$ 1,700.00

There were no internal controls in place to ensure that disbursements contain adequate supporting documents to substantiate the use of funds.

As a result, we were unable to determine that the \$1,700 was expended for youth programs in accordance with the intent of the appropriation.

Recommendation: We recommend that the Governor direct the State Treasurer to be more attentive in the disbursement of State funds to ensure that disbursements contain the proper supporting documents to substantiate the expenditure of funds. The supporting documents are essential as they form the basis to support the classification of expenditures and that such expenditures were incurred in accordance with the State budget.

Auditee's Response: *Yes. This is a real problem especially with the Sponsorol State Youth Organization. The members and officers are youths and often do not understand the importance of maintaining documents and reporting of their program's expenditure. However, judging from the dates of the checks we can be assured that these were expenditures for their group supplies needs or services rendered for special events; check no. 11245 - \$500 coincide*

with March 15 Youth Day celebration, National Holiday for the Republic. The remaining two check no. 11656 - \$1,000 and check no. 12312 - \$200 coincide with another national holiday celebration, October 1st, Independence Day. The State utilizes the youth organization every time there is some special event for the state and/or the Nation.

This does not justify the lack of supporting documents, but I can assure you that the State Treasury is currently more conscientious about keeping proper documents for all State disbursement and has developed improved forms to capture and maintain better supporting documentation.

OPA's Comments: In future appropriations for Youth Programs, the State (Governor and Legislature) should consider inserting reporting requirements for these funds to ensure that the youth program coordinators provide reports to the Office of the Governor on the expenditure of funds together with supporting documents.

Finding No. 12: Contractual Agreement for Professional Services

Procurement of professional services should be documented in a contractual agreement setting forth the nature of services to be provided and the contract should be executed prior to the provision of services.

We found that the State entered into an agreement with a mechanic to provide repair services for the State boat engine. A further review of the contract revealed that the contract was executed on November 11, 2010 but actual services were rendered from October 23 through 30, 2010, meaning the services were provided before the execution of the contract. In addition, the services were provided prior to certification by the State Treasurer that funds are available to incur expenditures.

The Governor did not enforce State policy by ensuring that the contract was certified for funds availability and approved before the provision of services.

As a result, State policy regarding certification of funds on the contract was circumvented.

Recommendation: We recommend that any contract for professional services should be certified for availability of funds and approved by the Governor and the contractor prior to the

provision of services. The certification of funds is a critical component of the control process as it implements the intent of the State budget.

Auditee's Response: *Concurred and taken very seriously. We at the State are currently very conscientious about this recommendation. The State Treasury has put into practice the recommendation of the auditor. We have developed forms for all financial transactions requiring the signature of the Treasurer certifying availability of funds first. We are also very conscientious with developing professional services contracts before services are rendered.*

OPA's Comments: The OPA commends the Governor for taking corrective action to resolve this finding. Certification of funds is the first line of internal control defense mechanism to prevent expenditure of funds without budget authority, whether by regular procurement, contract, payroll or otherwise. The bottom line is expenditures should not be incurred unless certification of funds first occurs.

Finding No. 13: Expenditures without Supporting Documents

A sound system of internal control dictates that expenditure should contain the proper supporting documents to justify the purpose of the expenditure, cost and quantities of goods and services purchased. Similarly, the same internal control system also requires source documents to support the recording of transactions in the accounting system.

Our audit revealed that the State expended \$46,905 without proper supporting documents to substantiate the official purposes of the expenditures, costs and quantities of goods and services purchased, and to support the recording of expenditures in the accounting system. The expenditures were incurred in fiscal years shown below:

Fiscal Year	Amount
2010	\$ 10,394
2011	9,434
2012	1,435
2013	25,642
Total	\$ 46,905

The Governor failed to enforce controls over disbursements to ensure that expenditures contain the appropriate supporting documents.

As a result, we were unable to determine the propriety of the expenditure of \$46,905 and their classification in the accounting system due to lack of supporting documents. Thus, these expenditures constitute questioned costs.

Recommendation: We recommend the Governor enforces controls over cash disbursements to ensure they contain the proper supporting documents. The State Treasurer should also be more diligent in following up on “open” disbursements, i.e. those without supporting documents, to ensure the documents are obtained and filed. To strengthen the controls, the Governor should direct the Treasurer to perform periodic reviews of disbursements to ensure that they contain the proper supporting documents and, when necessary, missing documents should be obtained.

Auditee’s Response: *We have attached all supporting documents we have for this finding no. 15 on questioned costs. We have made great improvements at the State Treasury; one of them is acquiring a 3-part laser check which leaves the 3rd part as the receipt. We have also agreed that the Treasury conduct a month review of its disbursement checks starting July 2016. Please see attachments.*

OPA’s Comments: The OPA will review the supporting documents and make changes as appropriate. We commend the Governor for taking corrective action to resolve this finding. Source documents are essential to justify expenditure of public funds and which expenditures must be in line with the intent of the State budget. In addition, the accuracy of the financial statements is dependent on the source documents supporting expenditures.



**ILLEGAL OR WASTEFUL ACTIVITIES
SHOULD BE REPORTED TO:**

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**MONDAY THRU FRIDAY
7:30 a.m. - 4:30 p.m.**

(Closed on Legal Holidays)