

July 1, 2009

Honorable Kerai Mariur
Vice President/
Minister of Administration
Republic of Palau:

In planning and performing our audit of the financial statements of the governmental activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Republic of Palau (the Republic) as of and for the year ended September 30, 2008 (on which we have issued our report dated July 1, 2009), 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, we considered the Republic's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Republic's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Republic's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting. However, in connection with our audit, we identified, and included in the attached Appendix I, deficiencies related to the Republic's internal control over financial reporting and other matters as of September 30, 2008 that we wish to bring to your attention.

We have also issued a separate report to His Excellency Johnson Toribiong, also dated July 1, 2009, on our consideration of the Republic's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters.

The definition of a deficiency is also set forth in the attached Appendix I.

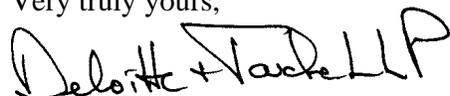
A description of the responsibility of management for establishing and maintaining internal control over financial reporting and of the objectives of and inherent limitations of internal control over financial reporting, is set forth in the attached Appendix II and should be read in conjunction with this report.

This report is intended solely for the information and use of the management of the Republic and the Office of the Public Auditor 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 will be pleased to discuss the attached comments with you and, if desired, to assist you in implementing any of the suggestions.

We wish to thank the staff and management of the Republic of Palau for their cooperation and assistance during the course of this engagement.

Very truly yours,



SECTION I – CONTROL DEFICIENCIES

We identified no control deficiencies involving the Republic’s internal control over financial reporting as of September 30, 2008.

SECTION II – OTHER MATTERS

We identified, and have included below, other matters involving the Republic’s internal control over financial reporting as of September 30, 2008 that we wish to bring to your attention:

1. Expenditures

Comment: Of nineteen Hospital Trust Fund expenditures tested totaling \$654,403 of a total population of \$1,981,306, expenditures of \$61,888 (check no. 264732) represented services for periods from 2003 to 2008. Additionally, the amount was supported by invoices of \$678,000 and a spreadsheet aggregating \$61,888 without adequate explanation.

Recommendation: We recommend that the National Hospital management implement policies and procedures to require reconciliation of vendor statements and forward timely data to the Division of Finance and Accounting, Ministry of Administration.

2. Expenditures

Comment: Tests of General Fund accounts payable noted journal voucher no. 698068 for \$28,800 (check no. 269432) which was supported by a receiving report but without indication of the date of the receipt of the items.

Recommendation: We recommend that management implement control procedures to ensure receiving reports are adequately documented to ensure that disbursements are recorded in the correct accounting period.

3. Expenditures

Comment: Pursuant to Section 202.7, Submission of Travel Requests, of the Republic’s Travel Policies and Procedures with an effective date of August 12, 2001, all planned travel authorizations must be completed and submitted for approval within 30 days prior to travel. Of 182 expenditures tested totaling \$315,118 of a total population of \$513,060, two travel authorizations were completed and approved less than 30 days prior to the travel period.

<u>Voucher No.</u>	<u>Check No.</u>	<u>Amount</u>
255474	662399	\$3,189
Unpaid	698567	\$2,602

Of forty-three expenditures tested totaling \$1,054,039 of a total population of \$1,211,251, one travel authorization was not completed and approved at least 30 days prior to the travel period.

<u>Voucher No.</u>	<u>Check No.</u>	<u>Amount</u>
668060	260225	\$ 751

Recommendation: We recommend that the Republic consider revising established travel policies and procedures to reflect current travel practices.

4. Expenditures

Comment: Of 182 expenditures tested totaling \$315,118 of a total population of \$507,357, the supporting invoice date for one \$5,275 disbursement (Check # 265399) preceded the date the contract or agreement was signed.

Recommendation: We recommend that the Republic review and strengthen controls in place surrounding the expenditure cycle.

5. Expenditures

Comment: Of thirty-nine disbursements tested totaling \$204,503, we noted that one disbursement, representing compensation for individuals for handling children who attended summer camps in Melekeok for emergency preparedness, lacked evidence that individuals attended the summer camp or received compensation (check no. 264652).

Recommendation: We recommend that the Republic ensure that expenditures are adequately supported prior to disbursement.

6. Expenditures

Comment: Of thirty-nine disbursements tested totaling \$204,503 we noted three transactions where original invoices or equivalent were not provided for examination (check nos. 249922, 249921, 264627).

Of twenty-five disbursement tested totaling \$121,335, we noted four transactions where original invoices or their equivalent were not located (check nos. 256766, 262373, 263952, 268798).

Recommendation: We recommend that the Republic ensure that expenditures are adequately supported prior to disbursement.

7. Expenditures

Comment: Of thirty-nine disbursements tested totaling \$204,503, seven disbursements were not supported by written certifications of completion or receiving reports or receiving reports did not list all items received prior to disbursement (check nos. 249922, 249921, 259141, 73127381, 264627, 264900, 265374).

Of twenty-five disbursements tested totaling \$121,335, four disbursements were not supported by written certifications of completion or receiving reports or receiving reports did not list items received prior to disbursement (check nos. 258974, 256766, 263952, 268798)

Recommendation: We recommend that the Republic ensure that expenditures are adequately supported by written certification receiving reports or detailed receiving reports prior to disbursement.

8. Expenditures

Comment: Of thirty-nine disbursements tested totaling \$204,503, we noted the following:

- Twelve travel authorization forms submitted were approved before thirty days of travel date (Voucher nos. 668837, 662420, 662416, 675287, 675286, 660641, 682751, 678733, 675266, 684287, 694480, 696976);
- Travel vouchers and related trip reports for two travel expenses were not submitted within 30 days of the completion of travel as required by established travel policies and procedures (Voucher no. 668837, 696976);

8. Expenditures, Continued

Of nineteen Hospital Trust Fund expenditures tested totaling \$654,403, we noted the following:

- One travel authorization form was approved subsequent to the date of the travel period (voucher no. 674375);
- One travel authorization form was not authorized by the certifying officer prior to disbursement (voucher no. 674375);
- A travel voucher was submitted; however, the boarding pass was not on file to support the expenditure (voucher no. 674375).

Recommendation: We recommend that the Republic consider revising established travel policies and procedures to reflect current travel practice. We recommend that ROP establish procedures to ensure that trip reports are filed with travel vouchers.

9. Expenditures

Comment: Of forty disbursements tested totaling \$181,892, three disbursements representing expenditures incurred in fiscal year 2007 were recorded in fiscal year 2008 (Accounts Payable Voucher nos. 666610, 666611, 666612).

Recommendation: We recommend that the Republic ensure that expenditures are recorded in the correct period.

10. Expenditure

Comment: Of twenty five expenditures tested totaling \$121,335, we noted one instance where the accounts payable voucher and the related invoice could not be located (accounts payable voucher no. 677339).

Recommendation: We recommend that accounts payable vouchers be reviewed to ensure completeness and be adequately filed.

11. Expenditures

Comment: Of nineteen Hospital Trust Fund expenditures tested totaling \$654,403, we noted that sixteen lack evidence of the receipt of purchased items:

<u>Voucher no.</u>	<u>Amount</u>	<u>Check no.</u>
686557	\$ 41,232	264735
662680	49,650	258719
686549	103,008	264735
672733	33,968	260674
672743	32,668	262435
686553	30,216	264735
679369	29,120	262536
662679	29,707	260674
662113	25,392	255685
672739	23,215	262435
688516	62,999	269607

11. Expenditures, Continued

<u>Voucher no.</u>	<u>Amount</u>	<u>Check no.</u>
662678	18,290	258719
680094	25,650	263709
662615	19,200	258719
692120	29,950	266913
688521	62,999	no payment

Recommendation: We recommend that the Republic implement uniform procedures to ensure receipt of procured items.

12. Expenditures

Comment: Of fifty-five general fund expenditures tested totaling \$937,985, we noted one transaction where the item procured represented fuel charges used by the MOH - Primary Care Program. However, the fuel charges were charged to MOH-Environmental Health. It was represented that the MOH – Primary Health Care exceeded the purchase order amount for fuel and the amount was allotted from MOH – Environmental Health to cover the difference. The amount should not be charged to MOH – Environmental Health as the fuel was used by MOH – Primary Health Care (check no. 268798).

Recommendation: We recommend that the Republic ensure that expenditures are charged to the correct org #'s.

13. Expenditures

Comment: An effective system of internal control includes policies and procedures to ensure that expenditures are authorized, supported, approved prior to incurrence and recorded in the correct period.

Our tests of expenditures noted the following:

- One of seventeen expenditures (wire transfer #70191408) tested totaling \$315,118 of a total population of \$513,060, in the amount of \$23,750, indicated that services were completed on July, 20, 2006 but the transaction was recorded on December 14, 2007, or seventeen months later. This situation was not corrected through a proposed audit adjustment as the amount was considered immaterial;
- For four of forty-three expenditures tested totaling \$1,054,039 of a total population of \$1,211,251, expenditures were incurred in 2004 and 2006 but were only recorded upon payment in fiscal year 2008. This situation was not corrected through a proposed audit adjustment as amount was considered immaterial;

<u>Check No.</u>	<u>Voucher No.</u>	<u>Amount</u>	<u>Year Incurred</u>
262436	675505	\$ 6,250	2004
262436	675509	6,250	2004
262436	675505	6,250	2004
262909	677274	<u>5,061</u>	2006
		<u>\$23,811</u>	

13. Expenditures, Continued

Of fifty seven general fund expenditures tested, totaling \$937,985, there was no supporting purchase requisition and inadequate documents were in the vendor file. This expenditure was incurred in December 2006; however, it was not corrected through a proposed audit adjustment as the amount was considered to be immaterial:

<u>Voucher no.</u>	<u>Check no.</u>	<u>Amount</u>
674654	260677	\$11,094

Recommendation: We recommend that the Republic ensure that prior approvals are obtained before the incurrence of expenditures. We further recommend that the Republic implement adequate procedures to ensure that expenditures are recorded in the proper period and reconciliation of vendor accounts is performed timely.

14. Expenditures

Comment: The amendment specified by Republic of Palau Public Law 7-25 (amendment to procurement law) applies to small purchases under \$5,000. For all small purchases over \$2,000 and for the purchase of event hosting services over \$5,000 not put to bid, the procurement officer or his designee shall obtain price quotations from at least three vendors and base the selection on competitive price, quality, delivery time and other relevant factors. Written documentation of the three price quotes, the vendors submitting the quotes and the basis for selection shall be maintained in the purchase order file. Small purchases under \$5,000 may be limited to local vendors. For small purchases under \$2,000 and for purchases of event hosting services under \$5,000, procurement officers are encouraged to obtain multiple price quotations, but it is not required. Three price quotations are not required for any small purchases under \$10,000 if there is adequate documentation that there are fewer than three suppliers of the items within the Republic. If items procured exceed \$10,000, a formal bid is required.

Of fifty seven general fund expenditures tested totaling \$937,985, the following were noted:

- There were no evidence in file that quotations were obtained from an adequate number of qualified sources for the following :

<u>Voucher</u>	<u>Check no.</u>	<u>Amount</u>
676741	261374	\$ 9,500
668525	257079	\$ 1,000
668765	258798	\$11,098
674654	260677	\$11,094

Of nineteen Hospital Trust Fund expenditures tested totaling \$654,403, of total expenditures of \$1,794,443, the following were noted:

- There were no evidence in file that quotations were obtained from an adequate number of qualified sources:

<u>Voucher</u>	<u>Check no.</u>	<u>Amount</u>
603631	75021914	\$5,549
674375	260218	\$3,813

14. Expenditures, Continued

- There was no evidence in file that the expenditure went through the formal bidding process:

<u>Voucher</u>	<u>Check no.</u>	<u>Amount</u>
681978	264732	\$79,563

- Three contracts were awarded to State Governments without going through the bidding process (contract nos. C70019, C80046, C90001).

Recommendation: We recommend that the Republic strengthen internal controls over procurement to maximize competition while maintaining the best interests of the Republic. If exceptions are allowed by procurement regulations, they should be reviewed and approved and the reasons therefore should be documented in the procurement files.

15. Expenditures

Comment: The accounting procedures and guidelines for receiving quarterly allotments by the off-island embassy offices, approved by the Minister of Finance, stipulate that all disbursements shall be in the form of a check in chronological sequence. A payment voucher is to be prepared for all checks issued and all supporting documents, such as invoices, etc. should be attached to the vouchers. All travel authorizations must be requested by the Minister of State and be approved by the President in accordance with Executive Order No. 199, the revised travel policy. Travel authorization approvals can be obtained via fax. A travel claim voucher is filed after travel is complete with all supporting documents attached.

Of fifty seven general fund expenditures tested, totaling \$937,985, reimbursements for January of fiscal year 2008 (Journal voucher #DF800070), 3rd quarter reimbursement of fiscal year 2008 (Journal voucher #DF800149) and first quarter, January and February 2008, and third quarter for fiscal year 2008 (Journal Voucher no. DF800175) to three foreign based offices noted the following:

<u>Check no./ Transaction no.</u>	<u>Amount</u>	<u>Descriptions</u>
None	\$ 6,148	No supporting documents for car rental
1258	\$ 10,090	No supporting invoice for air tickets
2007-4-54	\$ 479	No payment voucher
2007-4-64	\$ 397	FY 07 expenditures that were charged to FY08
2007-4-65	\$ 83	FY 07 expenditures that were charged to FY08

The check listing for the month of April 2008 was out of sequence (Journal voucher #DF800149).

Recommendation: We recommend that the Republic review and strengthen controls in place surrounding the expenditure cycle.

16. Expenditures

Comment: In accordance with the applicable procurement requirement, procurement shall provide full and open competition among vendors. Formal bidding is required for all items procured in excess of \$10,000. Per section 16 of the procurement policy, public notice for invitation for bid shall be made at a reasonable time at least fifteen days prior to the date of the initial day of the bidding time. The notice shall be furnished to all state governments and to all persons who have requested to be included in the bidders' mailing lists within the previous 12 months; be published in a news paper of general circulation within the Republic and shall be publicly posted for at least fifteen days at the office of the procurement officer concerned, the post office building, the Bureau of Domestic Affairs office, and announced on all radio and television stations within the Republic.

16. Expenditures, Continued

Furthermore, the contract must be awarded in accordance with this act with reasonable promptness, but in no event later than thirty days after the opening of the bid.

Of fifty-five general fund expenditures tested totaling \$937,985, we noted the following:

- There were instances where the public notice was less than 15 days for two requests for proposals (contract no. C80012, purchase order no. F80380);
- One contract was not awarded within thirty days after the opening of the bid as required by the Procurement Act (contract no. C80040).

Recommendation: We recommend that the Republic strengthen controls over procurement regulations. If exceptions are allowed by procurement regulations, they should be reviewed and approved and the reasons therefore should be documented in procurement files.

17. Payroll

Comment: The Republic’s Public Service System Rules & Regulations dated 1996 require that Overtime Requests and authorized forms be approved twenty-four hours in advance, whenever feasible, except in unanticipated emergencies. We noted one employee's overtime was approved on 2/21/08 while overtime hours occurred on 2/3/08, 2/9/08 and 2/16/08.

Recommendation: We recommend that overtime requests forms be approved in accordance with Public Service System Rules and Regulations.

This matter was discussed in our previous letter dated June 4, 2008.

18. Payroll

Comment: Approved timesheets should represent actual hours worked. Of one hundred four General fund payroll expenditures tested totaling \$120,201, we noted a variance between the time card and the approved timesheet for one employee (check no. 1156183) as follows:

<u>Description</u>	<u>Timecard</u>	<u>Approved Timesheet</u>	<u>Variance</u>
Regular Hours	32	72	40
Sick Leave Hours	40	0	40
Stand by Hours	16	16	0
Holiday Hours	<u>8</u>	<u>8</u>	0
Total Hours	<u>96</u>	<u>96</u>	

Recommendation: We recommend that the Republic ensure that hours recorded on approved timesheets represent actual time worked.

19. Payroll

Comment: Of forty-six payroll expenditures tested totaling \$21,364, we noted the following:

- Timecards were not signed or initialed by ten employees.

<u>Employee No.</u>	<u>Check No.</u>	<u>Pay</u> <u>Ending</u>	<u>Period</u>
32909	1152320		02/16/08
9553	1162436		04/12/08
30189	1167502		05/10/08
62670	1147276		01/19/08
39562	1152325		02/16/08
65152	1159925		03/29/08
406116	1170082		05/24/08
24417	1162437		04/12/08
38501	1152323		02/16/08
38591	1162445		04/12/08

- A timecard or equivalent could not be provided for one employee (check no. 1164993).

Recommendation: We recommend that the Republic enforce Public System Service System Rules and Regulations (1996) Part 2.2 subsection (e), which indicates that appropriate management officials shall develop and establish a time keeping system for employee within their respective branches or departments. Exceptions to this policy should be authorized and documented. The Republic should maintain documentation of compensatory time earned and taken by contract employees.

20. Payroll

Comment: Of forty-six payroll expenditures tested totaling \$21,364, employee personnel action forms and salary adjustments were not processed and completed on a timely basis for eleven employees:

<u>Employee No.</u>	<u>Check No.</u>	<u>Approval</u> <u>Date</u>	<u>Effective</u> <u>Date</u>	<u>Days</u> <u>Lapsed</u>
68600	1134806	05/24/07	10/01/06	235
75416	1149822	09/19/07	04/15/07	157
65152	1159925	03/03/06	01/01/06	61
61436	1139785	01/23/08	09/02/07	143
404052	1149833	03/30/07	08/06/06	236
32993	1132299	07/25/07	05/28/06	423

Recommendation: We recommend that the Republic ensure compliance with Public Service System Rules and Regulations (1996) Part 17.4 Subsection (2) which stipulates that appropriate management officials are responsible for ensuring that within-grade salary increases are initiated on a timely basis and the employees' supervisors are responsible for ensuring that all within-grade salary and merit increases are processed on a timely basis. We further recommend that new personnel action forms be completed, approved and filed to effect/update all salary adjustments on a timely basis.

21. Payroll

Comment: The Republic of Public Service System Rules and Regulations dated 1996 require that annual leave requests be approved in advance of the duration of the leave period. Further, personal leave requests should be submitted at least five days in advance. Of forty-six payroll expenditures tested totaling \$21,364, the annual leave form for one employee (check no. 1175093) was not approved prior to the leave period. Further, the personal leave request for one employee (check no. 1129835) was not made at least five days in advance.

Recommendation: We recommend that annual and personal leave request forms are completed and approved in accordance with Public Service System Rules and Regulations.

22. Payroll

Comment: Of forty-six payroll expenditures tested totaling \$21,364, variances between hours per timecards and approved timesheets existed for three employees:

<u>Employee No.</u>	<u>Check No.</u>	<u>Pay Period Ending</u>	<u>Regular Hours in Excess of Timecard</u>	<u>Excess Payment</u>
30189	1167502	05/10/08	8	47.94
39562	1152325	02/16/08	8	80.62
24417	1162437	04/12/08	4	33.81

Recommendation: We recommend that the Republic ensure that hours recorded on approved timesheets represent actual time worked.

23. Payroll

Comment: The Republic’s Public Service System Rules and Regulations dated 1996 require that annual leave forms be approved in advance of the duration of the leave period. Tests of payroll noted the following:

- Of forty payroll expenditures tested totaling \$42,829, the approved annual leave form for one employee appeared to have been approved after leave was incurred (check no. 1167603);
- Of one hundred four general fund payroll expenditures tested totaling \$120,201, approved annual leave forms for three employees appeared to have been approved after the annual leave period. (check no. 1135985, 1143575, 1191819).

The Republic’s Public Service System Rules and Regulations dated 1996 require that if annual leave is in excess of three working days, approval is required two days in advance. Of the one hundred four (104) general fund payroll expenditures tested totaling \$120,201, we noted three instances where the employees’ duration of annual leave exceeded three working days but the annual leave form was approved one day in advance (check nos. 1183578, 1175904, 1170277).

Recommendation: We recommend that annual leave forms be approved in accordance with the Republic’s Public Service System Rules and Regulations.

24. Payroll

Comment: Of forty payroll expenditures tested totaling \$42,829, time cards could not be provided for thirty-seven:

Of forty payroll expenditures tested totaling \$42,829, timecards and/ or time log sheets did not indicate employee initials for twenty-three employees:

Of twenty five payroll expenditures tested totaling \$19,149, time cards could not be provided for nine employees:

Of twenty five payroll expenditures tested totaling \$19,149, timecards or equivalent did not indicate employee's initials in four instances:

Of one hundred four (104) general fund payroll expenditures tested totaling \$120,201, we noted the following:

- Timecards or equivalent were not utilized because of the employee's position, therefore there was no evidence to support hours paid for sixteen employees:

<u>Pay Period Ending</u>	<u>Employee No.</u>	<u>Check No</u>
10/27/2007	14351	1130004
10/27/2007	25427	1131223
11/10/2007	406443	1133237
11/24/2007	3440	1135139
11/24/2007	7650	1135985
12/08/2007	39549	1137791
12/08/2007	29257	1138819
12/08/2007	27500	1139063
01/05/2008	3443	1142457
03/29/2008	16557	1158531, 1191369
05/24/2008	437342	1167880
06/07/2008	402627	1171253
06/21/2008	28395	1173979
07/05/2008	17637	1175366
09/13/2008	24388	1188253
09/27/2008	16765	1190582

- Timecards or equivalent did not indicate employee initials for forty-seven employees:

<u>Pay Period Ending</u>	<u>Employee No.</u>	<u>Check No</u>
10/13/2007	54525	1128297
10/13/2007	16187	1128429
10/13/2007	400687	1128821
10/13/2007	25527	1128877
10/13/2007	432000	1129064
10/13/2007	3583	1128567
10/13/2007	14837	1128632
10/27/2007	54603	1131432
11/10/2007	401976	1133389
11/10/2007	46795	1134703
11/24/2007	90304	1136277
11/24/2007	32844	1136078
12/8/2007	402089	1137529
12/22/2007	403175	1141007

24. Payroll, Continued

<u>Pay Period Ending</u>	<u>Employee No.</u>	<u>Check No</u>
01/05/2008	427027	1143300
01/05/2008	15783	1143303
01/05/2008	54674	1143337
01/05/2008	68732	1143667
01/05/2008	30838	1143575
01/05/2008	24347	1143572
02/02/2008	61892	1147763
02/02/2008	24325	1148424
02/02/2008	404507	1148539
02/16/2008	49592	1150870
03/01/2008	417783	1153309
03/15/2008	420897	1156417
03/15/2008	43167	1156433
03/15/2008	12888	1156277
03/29/2008	21396	1159701
03/29/2008	59880	1158649
04/12/2008	32961	1161383
04/12/2008	42439	1161678
04/12/2008	23432	1161322
05/10/2008	25537	1165971
05/10/2008	21360	1166127
05/10/2008	28352	1166250
05/10/2008	29299	1166304
05/24/2008	12914	1169122
05/24/2008	408044	1168767
06/07/2008	49505	1170836
07/05/2008	43312	1176704
07/05/2008	21449	1177401
07/19/2008	53917	1178733
07/19/2008	16521	1179152
07/19/2008	49501	1178822
08/02/2008	10912	1182560
09/13/2008	25553	1188068

- Timecards or equivalent lacked approval by the department head or immediate supervisor for thirty-four employees:

<u>Pay Period Ending</u>	<u>Employee No.</u>	<u>Check No</u>
10/13/2007	11474	1128135
10/13/2007	3583	1128567
10/13/2007	14837	1128632
10/27/2007	28326	1130661
11/10/2007	43051	1133123
11/10/2007	401976	1133389
11/10/2007	46795	1134703
12/8/2007	402089	1137529
12/22/2007	403175	1141007
01/05/2008	34376	1143123
01/05/2008	54674	1143337
01/05/2008	30838	1143575
01/05/2008	24347	1143572

24. Payroll, Continued

<u>Pay Period Ending</u>	<u>Employee No.</u>	<u>Check No</u>
02/02/2008	24325	1148424
02/02/2008	404507	1148539
03/01/2008	61490	1152999
03/01/2008	408583	1153249
03/15/2008	34409	1156016
03/29/2008	59880	1158649
04/12/2008	23584	1160780
04/12/2008	23432	1161322
05/10/2008	21360	1166127
05/10/2008	28352	1166250
05/10/2008	29299	1166304
05/24/2008	32075	1168212
05/24/2008	408044	1168767
06/07/2008	49505	1170836
06/07/2008	46993	1171323
07/05/2008	41856	1175904
07/19/2008	17654	1178110
07/19/2008	21434	1178560
07/19/2008	49501	1178822
08/16/2008	32078	1183294
08/30/2008	13012	1185862

- Timecards provided to support hours paid show a pay period ending from 1/02/08 through 1/12/08 which did not agree to the pay period tested. It was represented that there was a power outage which changed the date on the time clock from March to January; however there was no signature or correction made to the timecards. (check no. 1155158).

Recommendation: We recommend that the Republic enforce Public Service System Rules & Regulations (1996) Part 2.2 subsection (e), which indicates that appropriate management officials shall develop and establish time keeping system for employees within their respective branches or departments. Exceptions to this policy should be documented. We also recommend that the Republic ensure that hours recorded on approved timesheets represent actual time worked.

25. Payroll

Comment: Of forty payroll expenditures tested totaling \$42,829, we noted the following:

- One instance in which an organization number on the approved employee personnel action form was incorrect and therefore 50% of the employee's salary for eight pay periods totaling \$2,821 was wrongly charged (check no. 1175183). Additionally, a correcting entry (journal voucher no. DF800208) did not correct the organization number in accordance with the approved employee personnel action form;

Recommendation: We recommend that the Republic ensure employees' hours are charged to the correct organization number.

APPENDIX I, CONTINUED

26. Payroll

Comment: The Republic's Public Service System Rules & Regulations dated 1996 require that Overtime Requests and authorized forms be approved twenty-four hours in advance, when ever feasible, except in unanticipated emergencies. Of twenty-five payroll expenditures tested totaling \$19,149, the following were noted where overtime request authorization forms were approved after the overtime period:

<u>Employee no.</u>	<u>Check no.</u>	<u>Overtime Dates</u>	<u>Approval Date</u>
66546	1148483	12/27/07	01/28/08
40173	01152462	1/3/08 to 1/4/08, 1/7/08 to 1/11/08 1/17/08	2/4/08
65144	1144834	12/19/07	1/3/08
30868	1144866	12/19/07 to 12/20/07	1/3/08

Of one hundred four general fund payroll expenditures tested totaling \$120,201, we noted the following;

- There was one instance where the Overtime Request and authorization form were approved after the overtime period;

<u>Employee no.</u>	<u>Check no.</u>	<u>Overtime Dates</u>	<u>Approval Date</u>
27500	1139063	9/18/08 to 9/23/08	9/29/08

- There was one instance where overtime hours were paid but the Overtime Requests and Authorization forms were not provided for examination (check no. 1136277).

Recommendation: We recommend that overtime request forms be approved in accordance with Public Service System Rules and Regulations.

27. Payroll

Comment: The Republic's Public Service System Rules and Regulation dated 1996, page 67, section (iv) state that employees being paid standby differential are not eligible to receive payment for night work differential, holiday pay, or overtime pay for any work performed while serving a scheduled standby. Of forty six payroll expenditures tested totaling \$42,829, one employee worked one day on standby during a holiday and was paid for eight hours holiday and sixteen hours of standby (c heck no. 1171352, employee no. 32959).

Recommendation: We recommend that the Republic enforce Public Service System Rules and Regulation (1996), page 67, (iv) which states that employees being paid standby differential are not eligible to receive payment for night work differential, holiday pay, or overtime pay for any work performed while serving a scheduled standby.

28. Cash

Comment: Our examination of cash receipts noted an understatement of other revenues of approximately \$38,352 which primarily represent bank overdraft fees incurred during the year ended September 30, 2008.

Recommendation: We recommend that the Republic strengthen controls over cash management to ensure that check disbursements do not exceed existing cash in bank balances.

29. Cash

Comment: Bank accounts should be reconciled and reviewed on a monthly basis and reconciling differences should be resolved.

Tests of the payroll bank account no. 105 reconciliation for September 2008 noted the following:

- A deposit in transit totaling \$156,171 cleared the bank in the month of September 2008:

<u>Date Cleared by Bank</u>	<u>Amount</u>
9/29/08	\$ 110,989
9/30/08	<u>45,182</u>
	\$ <u>156,171</u>

- Bank sweeps in transit of \$87,579 lacked supporting detail.

The cutoff date for the payroll bank account no. 105 reconciliation was September 28, 2008 based on the bank statement cut off rather than the Republic's fiscal year end of September 30, 2008. In addition, a note on the reconciliation template stipulates that the recorded balance and the reconciled bank balance should be zero. The recorded balance and the reconciliation are therefore adjusted and reconciled to zero regardless of the true cash balance.

Recommendation: Bank reconciliations should be correctly reconciled on a monthly basis.

30. Revenues

Comment: Of twenty seven gross receipts tax returns tested totaling \$8,587,573, we noted one instance where the tax form was paid one day after the due date. Penalties and interest were assessed but were not collected. (Cash receipt no. 981566).

Recommendation: We recommend that the Republic ensure that penalties and interest are collected.

31. Revenues

Comment: Of twenty seven gross receipts tax returns tested totaling \$8,587,573, we noted one instance where the tax form was paid one day after the due date. Penalties and interest were assessed but were not collected. (Cash receipt no. 981566).

Recommendation: We recommend that the Republic ensure that penalties and interest are collected.

32. Revenues

Comment: Of twenty five fish export and import tax returns tested totaling \$2,081,612, the following were noted:

One cash receipt (cash receipt # 1016087) was recorded as liquor while the supporting form showed that the correct classification should have been beer;

Recommendation: We recommend that support for all tax collections and other receipts be posted to correct general ledger control accounts.

33. Revenues

Comment: Of twenty five fish export and import tax returns tested totaling \$2,081,612, the following were noted:

There was a variance in the total quantity noted on the invoice and the import tax assessment form. It was represented that the import tax assessment form was not verified against the invoice (cash receipt no. 1023328).

Recommendation: We recommend that the Republic ensure that import tax assessment forms are verified against invoices.

34. Revenues

Comment: During tests of postal service revenues of \$7,044, we noted variances between the 1412 form and actual cash collected. It was represented that the amount was a typing error during the recording of sales in the 1412 form (cash receipt # 989656).

Recommendation: We recommend that the Republic ensure that 1412 forms are verified on a periodic basis.

35. Revenues

Comment: Of \$1,886,074 of Hospital Trust Fund revenues, seventeen receipts totaling \$160,803 were tested and the following noted:

- No independent source supports the number of dependents in the patient individual/master record provided by the head of family;
- Recorded income in the patient individual/master record in not updated to reflect current year income.

Recommendation: We recommend that the number of family members, including dependents provided by the family head, be supported by an independent source. We also recommend that the Republic implement procedures whereby financial information provided for sales discounts is updated to reflect current year income.

36. Receivables

Comment: In tests of Other Grants deferred revenues, (which does not include U. S. federal program funds) fund 360100, we noted the following:

- The schedule of expenditures provided should agree to the amount recorded in the general ledger. The total amount due to grantor does not agree to the amount recorded in the general ledger;
- The balance of the schedule of expenditures should be reviewed for mechanical accuracy; however , the balances at 9/30/08 are not correctly compiled as the formulas were not reviewed for mechanical errors;
- We noted six mechanical errors;
- The total grant amount per the schedule of expenditures should agree to the grant amount awarded; however, one grant award did not agree with the grant amount awarded (cost center no. F53929);

36. Receivables, Continued

- Total grants entered in the schedule of the expenditures should be supported by grant awards; however, two grant awards could not be provided for examination (cost center no. A83966, R83971).

Recommendation: We recommend that the Republic establish procedures to ensure that amounts entered in the schedule of expenditures agree to the general ledger. We also recommend that the Republic ensure that schedules be reviewed for mechanical accuracy. We also recommend that the Republic ensure that total grant amounts are supported by grant awards and that the amounts agree.

37. Receivables

Comment: In tests of deferred revenue from Other Country CIP fund 440100, six grant amounts did not agree with grant awards as follows:

<u>Grant</u>	<u>Cost Center</u>	<u>Grant amount Per schedule</u>	<u>Grant amount per grant award</u>	<u>Variance</u>
State Economic Stimulus Package 2003		\$1,909,000	\$2,000,000	\$ (91,000)
State Economic Stimulus Package 2004		\$3,027,449	\$2,800,000	227,449
State Economic Stimulus Package 2006		\$4,990,000	\$4,400,000	590,000
Inter-Island Water Trans	R44893	\$ 791,000	\$ 600,000	191,000
BPS Equip Imrpv Grant	J34920	\$ 664,000	\$ 600,000	64,000
State Economic Stimulus Package 200022		\$ 798,665	\$1,000,000	201,335

Recommendation: We recommend that the Republic establish procedures to ensure that grant amounts are supported by grant awards or equivalent.

38. Receivables

Comment: During tests of Airport Use Rental Fees totaling \$211,513 we noted the following:

Airport space rentals should be supported by a signed agreement or contract; however there was no signed agreement or contract provided for one cash receipt tested (cash receipt no. 10136010).

Recommendation: We recommend that the Republic establish procedures to ensure that all applicable agreements or contracts are maintained in a centralized area.

39. Collection Letters/Notices – Hospital

Comment: Billings/statements of accounts (SOA) should be sent to customers in a timely manner. Additionally, good practice provides for monitoring billings/SOAs to ensure that such were sent to all patients with outstanding balances and that timely follow up is performed through sending necessary collection notices/letters. Furthermore, discounts of a patient billing should be supported by an approved agreement prior to applying the discount.

Of \$1,886,074 in Hospital Trust fund revenues, seventeen receipts totaling \$160,803 were tested. The following were noted:

- There were no subsequent collections for two patients and there is no logbook or other records maintained to document that billings/SOAs are actually forwarded to patients (hospital nos. 9579, 27337);

39. Collection Letters/Notices – Hospital

- A 50% discount was applied to a patient (hospital no. 62320) billing on 2/23/08 based on an agreement with a certain community association; however, the agreement expired on 12/31/07 and no approved extension could be located.

Recommendation: We recommend that the Hospital establish policies and procedures to monitor billings/SOAs and ensure that billings/SOAs and collection letters/notices are provided to patients in a timely manner. We also recommend that the Hospital establish procedures to ensure that discounts are supported by an approved agreement.

40. Accounts Receivables

Comment: As a control procedure, the general ledger balance of accounts receivable should be reconciled to the subsidiary ledger and differences should be timely resolved. In addition, a monthly or quarterly reserve analysis should be performed and be documented.

An examination of the accounts receivable general ledger account detail in the General Fund (account no. 216) and related records revealed a lack of reconciliation procedures and management review throughout the year ended September 30, 2008. An assessment of the allowance for doubtful accounts is not performed.

The grants receivable general ledger account balance in the Other Country CIP fund was not reconciled throughout the year ended September 30, 2008. A supporting schedule was subsequently prepared through the audit request process.

Recommendation: We recommend that management implement policies and procedures to provide for accounts receivable to be reconciled in a timely manner.

41. Inventory

Comment: The Republic of Palau did not have supplies on hand at September 30, 2008; however, the financial statements reported inventory of \$46,467. There was no adjustment proposed as the amount was considered immaterial.

Recommendation: We recommend that management correct its financial statements.

42. Travel Advances

Comment: Tests of travel advances noted one travel advance (TA no. T8080001) in the amount of \$4,968 in which the related travel claim report was approved on September 29, 2008 but the travel authorization was still listed as outstanding at September 30, 2008.

It was represented that the general ledger account no. 251 for travel advances is no longer being used; however, recorded balances at September 30, 2008 were noted as follows:

<u>Fund</u>	<u>Balance at</u> <u>9/30/08</u>
100100	\$33,235
350100	\$24,791

42. Travel Advances, Continued

Unreconciled variances were noted between the recorded travel advances account no. 250 and the travel advances schedule per CAPPs (the subsidiary ledger) as follows:

<u>Fund</u>	<u>DILOG</u>	<u>CAPPs</u>	<u>Variance</u>
100100	\$163,546	\$121,936	\$41,610
100200	28,601	14,714	13,887
350100	64,427	30,111	34,316
350200	29,067	25,990	3,077
360100	35,450	23,953	11,497

General ledger account no. 511 records employee payroll deductions related to travel advances. This account reported a balance of \$13,360 and did not appear to be reconciled at September 30, 2008.

Recommendation: We recommend that management implement policies and procedures to reconcile travel advances accounts on a monthly basis.

43. Investment

Comment: Investment account number 143 in the General Fund was overstated by \$120,000 at September 30, 2008 as a result of a duplicate entry. An audit adjustment was proposed to correct this situation.

Recommendation: We recommend that investment accounts be reconciled at month end and reconciling differences be timely resolved.

44. Operating Transfers Out

Comment: Tests of operating transfers out noted an erroneous entry of \$186,895 under the Office of the Public Auditor. This situation was corrected through a proposed audit adjustment.

Recommendation: We recommend that management perform a review of operating transfers out to ensure that transfers are in accordance with the Annual Budget Act.

45. Journal Voucher Entries

Comment: Tests of investments noted journal voucher entry no. DC800028 which was prepared on 10/31/08 and posted in the general ledger account on the same day; however, the journal voucher entry was approved on 11/12/08, or twelve days later.

Recommendation: We recommend that management approve journal voucher entry prior to posting to general ledger.

46. Tax Refund

Comment: The rules and regulations on refunds of contributions to non-profit organizations, tuition payments, and/or overpayment of wage and salary tax, pursuant to Republic of Palau Public Law 7-13 and approved on October 11, 2006, stipulates that the Director shall refund the amount over paid or contributed within ninety (90) days after the end of that tax year or March 30, 2009. Of three tax refunds tested totaling \$328,704, two applications for refunds totaling \$231,265 were approved for payment by April 30, 2009 and had not been disbursed to the taxpayers as of May 2009.

46. Tax Refund, Continued

Recommendation: We recommend that the Division of Revenue and Taxation revise its current tax refund procedures in accordance with its rules and regulations. Taxpayers may be given sixty days to submit applications for refunds which will allow time for the Ministry of Finance to process and disburse tax refunds within ninety days of the tax year.

47. Accounts Payable

Comment: Security deposits by employers of expatriate employees in the amount of \$139,384 at September 30, 2008 did not appear to be reconciled as this balance was merely supported by a list of debit and credit postings from 2003 to 2008. Bid bonds in the amount of \$4,639 did not appear to be reconciled as this balance was only supported by a list of credit postings dated between 1999 and 2001.

Recommendation: We recommend that the Bureau of National Treasury implement procedures to reconcile security deposits and bid bonds on a periodic basis.

48. Other Revenues

Comment: The Division of Land and Survey (the Division) provides land survey services to private individuals and other entities in which the related fees collected are recorded in the nonlapsing fund 100200 for specific use by the Division. The Division's services fees collected during the year ended September 30, 2008 amounted to \$17,512.

Recommendation: We recommend that an agreement or equivalent be established to restrict the use of the Division's service fees as all collections should be remitted to the National Treasury subject to appropriation.

49. File Maintenance

Comment: The current filing practice at the Division of Finance and Accounting requires original copies of purchase orders, requisitions and vendor quotes to be attached to related accounts payable vouchers (APV) and be filed by check number. While this is not the case for open purchase orders, there is no documentation on the APV to indicate the existence or alternative filing of original copies of open purchase orders and related documents.

Of 182 expenditures tested totaling \$315,118 of a total population of \$513,060, one hundred twenty two (122) accounts payable vouchers (APV) were based on one open purchase order no. 580053 and twenty five (25) APV were based on one purchase order no. U80026 in which the original purchase orders were not provided upon initial request nor were they attached to any APV. Additionally, there was no reference on any of the APV's to indicate existence or alternative filing of the original purchase order and the related pertinent documents.

Recommendation: We recommend that the audit trail and filing of open purchase orders be improved by documenting on the face of the accounts payable vouchers where related original purchase orders and purchase requisitions are filed.

50. Encumbrance

Comment: Of twenty nine encumbrances tested totaling \$8,426,167, we noted the following:

Amounts recorded in the encumbrance schedule should agree with obligating contracts. Changes to the obligating contract should be documented in the contract file. However, there were two instances where contract balances did not agree with the original contract amount recorded in the encumbrance schedule (Contract nos. C80001, D80034). It was represented that the encumbrance was not reconciled and therefore, did not agree with changes to the obligating contract.

The org and acct # to which the encumbrance has been posted should agree to the originating contract. All changes should be documented in the contract file. However, we noted one instance where the org and acct # per the encumbrance schedule did not agree with the originating contract (Contract no. C80001).

Recommendation: We recommend that the Republic establish procedures to ensure that the encumbrance schedule is reconciled on a periodic basis. Additionally, changes to the org and acct # charged should be documented.

51. Prepaid

Comment: As a control procedure, the prepaids general ledger balance should be reconciled to the subsidiary ledger and differences resolved in a timely manner.

The prepaids general ledger account does not appear to have been reconciled at September 30, 2008. During tests of prepaids, we noted the following:

- Of total prepaids of \$749,883 at September 30, 2008, 9.8% or \$73,852 date from 2003 to 2007;
- An amount of \$150,400 (check no. 74116855) was listed as prepaid at September 30, 2008; however, the related item had been received prior to September 30, 2008. An audit adjustment was proposed to correct this condition.

There is no mechanism in place to ensure that information related to receipt of items or service completion for which advance payments were made is forwarded to the Division of Finance and Accounting for recording.

Recommendation: We recommend that management implement policies and procedures to ensure that prepaids are reconciled in a timely manner.

52. Fixed Assets

Comment: The Republic of Palau Property Management Policies and Procedures Chapter IV, stipulate the following:

- Section 202.3: The Accountable Officer shall be the manager at the Director level of each respective organization entity (or Chief of Staff at the President's Office). The Boards, Commissions and Authorities will advise the Minister of Finance of the person delegated to control fixed assets. These officers will be responsible for:...(d) ensuring the proper and effective maintenance, control and safeguarding of government property assigned to or utilized by their respective entities;

52. Fixed Assets, Continued

- Section 203.4 (d): total value of capitalized property recorded in the property accountability records will be compared with the related balances shown in the general ledger control account at least quarterly. Property records must be integrated with or reconciled with the related general ledger account. Any differences will be documented, reconciled, and adjusted in accordance with sound accounting practices to bring the two records into complete agreement.

Our test of capital assets noted the following:

- Of eleven capital assets tested with a net book value of \$3,644,344, one standby generator with a net book value of \$1,280,000, which was running daily as of our test date, lacked an effective maintenance plan to ensure that the asset can maximize its useful life;
- Property records were not reconciled at least quarterly throughout the year ended September 30, 2008. Depreciation schedules were subsequently prepared through the audit request process.

Recommendation: We recommend that management implement policies and procedures as set forth in the criteria.

53. Accounts Payable

Comment: An Accounts payable voucher supporting the payment of stipends did not contain any supporting documents. It was represented that the related documents may have been attached to other vouchers for the same payment as the memo supports several disbursements; however, the accounts payable voucher did not reference where the related documents were located (check nos. 248217, 247437).

Of sixty-one General fund expenditures tested totaling \$1,180,189, three expenditures were incurred under open purchase orders and no evidence was on file evidencing whether actual expenditures exceeded the amount authorized:

<u>Voucher no.</u>	<u>Check No</u>	<u>Amount</u>
602587	242794	\$ 121
627186	248401	8,991
628650	249111	561

Recommendation: We recommend that the filing system be improved to provide an adequate audit trail for recorded expenditures including open purchase orders and stipend payments.

54. Reporting

Comment: The Republic's share of allowable costs or its matching share should be recognized as costs are incurred.

Although the Republic appears to meet its share of allowable costs, amounts were not accounted for in the general ledger. It appears to be the Republic's policy to document the match only upon its year-end reconciliation process. Therefore, interim financial statements are presented incorrectly.

Recommendation: We recommend that the Republic's management implement procedures to record the Republic's share of allowable costs as such are incurred.

55. Local Compliance

Comment: The 2008 Budget Act appropriates for the rental of certain Koror State housing units pursuant to a Land Settlement Agreement executed February 3, 1997, to the extent the same or greater amount is first collected from Koror State pursuant to the law that requires 25% of revenues of lease rental collected by Koror State to be remitted to the National Treasury.

There were no rental payments made to or revenue received from Koror State Government during the year ended September 30, 2008.

Recommendation: We recommend that the Republic document in writing ongoing dialogue with Koror State in an attempt to comply with the above requirement.

SECTION III – DEFINITIONS

The definition of a deficiency that is established in AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, is as follows:

A *deficiency* 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 deficiency in design exists when (a) a control necessary to meet the control objective is missing or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when (a) a properly designed control does not operate as designed, or (b) the person performing the control does not possess the necessary authority or competence to perform the control effectively.

MANAGEMENT'S RESPONSIBILITY FOR, AND THE OBJECTIVES AND LIMITATIONS OF, INTERNAL CONTROL OVER FINANCIAL REPORTING

The following comments concerning management's responsibility for internal control over financial reporting and the objectives and inherent limitations of internal control over financial reporting are adapted from auditing standards generally accepted in the United States of America.

Management's Responsibility

The Republic's management is responsible for the overall accuracy of the financial statements and their conformity with generally accepted accounting principles. In this regard, management is also responsible for establishing and maintaining effective internal control over financial reporting.

Objectives of Internal Control over Financial Reporting

Internal control over financial reporting is a process affected by those charged with governance, management, and other personnel and designed to provide reasonable assurance about the achievement of the entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations. Internal control over the safeguarding of assets against unauthorized acquisition, use, or disposition may include controls related to financial reporting and operations objectives. Generally, controls that are relevant to an audit of financial statements are those that pertain to the entity's objective of reliable financial reporting (i.e., the preparation of reliable financial statements that are fairly presented in conformity with generally accepted accounting principles).

Inherent Limitations of Internal Control over Financial Reporting

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.