

PALAU COMMUNITY ACTION AGENCY
(A NONPROFIT CORPORATION)

INDEPENDENT AUDITORS' REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2002



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON
INTERNAL CONTROL OVER FINANCIAL REPORTING BASED
UPON THE AUDIT PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Palau Community Action Agency:

We have audited the financial statements of the Palau Community Action Agency (the Agency), as of and for the year ended September 30, 2002, and have issued our report thereon dated July 4, 2003. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Agency's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Agency's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. We noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated July 4, 2003.

This report is intended solely for the information and use of the management of the Agency, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche

July 4, 2003



INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND
INTERNAL CONTROL OVER COMPLIANCE APPLICABLE
TO EACH MAJOR FEDERAL AWARD PROGRAM AND ON
THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

Board of Directors
Palau Community Action Agency:

Compliance

We have audited the compliance of the Palau Community Action Agency (the Agency) with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to its one major federal program for the year ended September 30, 2002. The Agency's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs (pages 9 through 12). Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Agency's management. Our responsibility is to express an opinion on the Agency's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Agency's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Agency's compliance with those requirements.

As described in Findings 2002-1 through 2002-3, in the accompanying Schedule of Findings and Questioned Costs, the Agency did not comply with requirements regarding equipment and real property management, procurement and suspension and debarment and eligibility that are applicable to its major federal programs. Compliance with such requirements is necessary, in our opinion, to comply with requirements applicable to those programs.

In our opinion, except for the noncompliance described in the preceding paragraph, the Agency complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2002.

Internal Control Over Compliance

The management of the Agency is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Agency's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

We noted certain matters involving the internal control over compliance and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in our judgment, could adversely affect the Agency's ability to administer a major federal program in accordance with applicable requirements of laws, regulations contracts and grants. Reportable conditions are described in the accompanying Schedule of Findings and Questioned Costs as Findings 2002-1 through 2002-3.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not consider the reportable conditions described above to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Agency as of and for the year ended September 30, 2002, and have issued our report thereon dated July 4, 2003. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (page 6) is presented for the purpose of additional analysis as required by OMB Circular A-133 and is not a required part of the financial statements. This schedule is the responsibility of the management of the Agency. Such information has been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, is fairly stated, in all material respects, when considered in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the management of the Agency, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche

July 4, 2003

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Schedule of Awards Selected for Audit in
Accordance with OMB Circular A-133
Year Ended September 30, 2002

The following list specifies the major federal awards selected for detailed compliance testing in accordance with applicable OMB Circular A-133 requirements.

<u>Original Grantor</u>	<u>CFDA #</u>	<u>Description</u>	<u>Expenditures</u>
U.S. Department of Health and Human Services	93.600	Head Start Program	\$ 1,415,724
U.S. Department of the Interior	15.875	Agreement between the Government of the United States and the Government of the Republic of Palau for the Implementation of Section 211(b) of the Compact of Free Association	<u>300,000</u>
		Total program expenditures tested	\$ <u>1,715,724</u>
		Total federal program expenditures	\$ <u>2,025,416</u>
		% of total federal program expenditures tested	<u>85%</u>

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Program or Award Amount</u>	<u>Net Assets at 9/30/01</u>	<u>Other Revenues</u>	<u>Expenses and Acquisition of Equipment</u>	<u>Lapsed Funding</u>	<u>Net Assets at 9/30/02</u>
<u>U.S. Department of Education</u>							
Direct grant:							
Parental Assistant Program	83.310A	\$ 107,360	\$ 140,467	\$ -	\$ 119,743	\$ -	\$ 128,084
Total U.S. Department of Education		<u>107,360</u>	<u>140,467</u>	<u>-</u>	<u>119,743</u>	<u>-</u>	<u>128,084</u>
<u>U.S. Department of Health and Human Services</u>							
Direct grants:							
Head Start Program	93.600	1,387,355	3,505	14,740	1,415,724	30,000	(40,124)
Pass through grant:							
Maternal and Child Health Bureau Grant	93.994	-	2,861	-	-	-	2,861
Total U.S. Department of Health and Human Services		<u>1,387,355</u>	<u>6,366</u>	<u>14,740</u>	<u>1,415,724</u>	<u>30,000</u>	<u>(37,263)</u>
<u>U.S. Department of the Interior</u>							
Direct grant:							
Historical Preservation Program	15.904	197,073	159,428	500	189,949	-	167,052
Pass through grant:							
Agreement between the Government of the United States and the Government of the Republic of Palau for the Implementation of Section 211(b) of the Compact of Free Association	15.875	300,000	-	-	300,000	-	-
Total U.S. Department of the Interior		<u>497,073</u>	<u>159,428</u>	<u>500</u>	<u>489,949</u>	<u>-</u>	<u>167,052</u>
Total Federal Awards		<u>\$ 1,991,788</u>	<u>\$ 306,261</u>	<u>\$ 15,240</u>	<u>\$ 2,025,416</u>	<u>\$ 30,000</u>	<u>\$ 257,873</u>

See accompanying notes to the schedule of expenditures of federal awards.

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

(1) Scope of Review

The Palau Community Action Agency (the Agency) was incorporated in 1967, under the laws of the Trust Territory of the Pacific Islands, as a nonprofit corporation. The primary purpose of the Agency is to administer community action programs and other related anti-poverty programs, as well as other programs for which it has been appointed as the Grantee Agency. The U.S. Department of the Interior has been designated as the Agency's cognizant audit agency.

Programs Subject to OMB Circular A-133

The Schedule of Expenditures of Federal Awards presents each Federal program related to the U.S. Department of Education, U.S. Department of Health and Human Services and the U.S. Department of the Interior, which are subject to OMB Circular A-133.

(2) Summary of Significant Accounting Policies

Basis of Accounting

For purposes of preparation of the accompanying Schedule of Expenditures of Federal Awards, certain accounting procedures were followed, which help illustrate the program award amount and expenditures of the individual programs. The Schedule of Expenditures of Federal Awards is presented on the accrual basis of accounting. All program or award amounts represent the total allotment or grant award received. All expenses and acquisition of equipment are reported as such.

Indirect Cost Allocation

For fiscal year 2002, the Agency had an approved indirect cost rate of 9.0% from the U.S. Department of Health and Human Services.

(3) Definition of Federal Awards Received

United States Department of Education

• Direct Grant

The Agency received directly from the U.S. Department of Education, a grant to fund the Parental Assistance Program.

United States Department of Health and Human Services

• Direct Grants

The Agency received a grant directly from the U.S. Department of Health and Human Services, to fund the Head Start Program.

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2002

(3) Definition of Federal Awards Received, Continued

United States Department of Health and Human Services, Continued

• Grants Passed Through to the Agency

One U.S. Department of Health and Human Services grant is passed through another entity to the Agency. This grant is as follows:

- Maternal and Child Health Bureau Grant

United States Department of the Interior

• Direct Grant

The Agency received directly from the U.S. Department of the Interior, a grant to fund the Historical Preservation program.

PALAU COMMUNITY ACTION AGENCY
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Schedule of Findings and Questioned Costs
Year Ended September 30, 2002

Section I - Summary of Auditors' Results

1. The Independent Auditors' Report on the financial statements expressed an unqualified opinion.
2. No reportable conditions in internal control over financial reporting were identified.
3. No instances of noncompliance considered material to the financial statements were disclosed by the audit.
4. Reportable conditions in internal control over compliance with requirements applicable to major federal award programs were identified, none which were considered to be a material weakness.
5. The Independent Auditors' Report on compliance with requirements applicable to major federal award programs expressed a qualified opinion.
6. The audit disclosed findings required to be reported by OMB Circular A-133.
7. The Agency's two major programs were:

<u>Name of Federal Program or Cluster</u>	<u>CFDA Number</u>
Head Start Program	93.600
Agreement between the Government of the United States and the Government of the Republic of Palau for the Implementation of Section 211(b) of the Compact of Free Association	15.875

8. A threshold of \$300,000 was used to distinguish between Type A and Type B programs as those terms are defined in OMB Circular A-133.
9. The Agency did not qualify as a low-risk auditee as that term is defined in OMB Circular A-133.

Section II - Financial Statement Findings

No financial statement findings were reported.

Section III - Federal Award Findings and Questioned Costs

<u>Reference Number</u>	<u>Findings</u>	<u>Questioned Cost</u>	<u>Refer Page #</u>
2002-1	Equipment and Real Property Management	\$ -	10
2002-2	Procurement and Suspension and Debarment	\$ -	11
2002-3	Eligibility	\$ -	12

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Section III - Federal Award Findings and Questioned Costs Section

Equipment and Real Property Management - All Federal Awards

Finding No. 2002-1

Criteria: In accordance with OMB Circular A-110, Attachment N, the Agency shall establish adequate property management standards which shall include accurate property records and a physical inventory of property at least once every two years. The results of the physical inventory must be reconciled to the property records and variances are to be investigated.

Condition: The Agency last conducted a physical inventory of its capital assets during the year ended September 30, 2000. A physical inventory of property commenced subsequent to September 30, 2002 but has not been completed.

Cause: The cause of the above condition is that the Agency has not established adequate property management standards.

Effect: The effect of the above condition is that the Agency may not be accurately identifying assets that are lost, broken or unutilized.

Recommendation: We recommend that the Agency conduct a physical inventory of its capital assets and reconcile the physical inventory to property records.

Prior Year Status: Not conducting physical inventories of property and required reconciliations was reported as a finding in the audits of the Agency for fiscal years 1992 through 2001.

PALAU COMMUNITY ACTION AGENCY
(A Nonprofit Corporation)

Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Procurement and Suspension and Debarment - Head Start Program
CFDA #93.600

Finding No. 2002-2

Criteria: OMB Circular A-110, subpart C.45 states that some form of cost or price analysis shall be made and documented in connection with every procurement action.

Condition: Of nineteen Head Start disbursements tested totaling \$133,937, oral explanations were obtained to justify the following disbursements:

<u>Check Nos.</u>	<u>Amount</u>
29495	\$ 5,527
29647	\$ 2,753
28163	\$ 4,919
AJ 99	\$ 2,806
29772	\$ 2,829
DJ 65	\$ 3,650

Cause: The cause of the above condition is inadequate documentation for small purchases.

Effect: The effect of the above condition is potential noncompliance with federal procurement regulations. However, no questioned costs result from this condition as satisfactory management explanations were received.

Recommendation: We recommend that the Agency document procurement of small purchases to comply with OMB Circular A-110 subpart C.45.

PALAU COMMUNITY ACTION AGENCY
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Schedule of Findings and Questioned Costs, Continued
Year Ended September 30, 2002

Eligibility - Head Start Program
CFDA #93.600

Finding No. 2002-3

Criteria: Head Start enrollment must consist of children between the age of three and the age of compulsory school attendance (six years old by Sept. 1) unless the grant award provides otherwise. Per 45 CFR § 1305.4, the family income must be verified by the Head Start program before determining that a child is eligible to participate in the program. At least ninety percent of the enrollees must come from families whose income is below the official Federal poverty guidelines.

Condition: Of twenty-five students tested, we noted ten application files (hospital nos.: 67404, 55607, 55273, 62761, 53332, 56146, 56080, 54667, 55995 and 59442) lacked documentation for income verification.

Cause: The cause of the above condition is that established enrollment guidelines have not been adequately implemented.

Effect: The effect of the above condition is the possible enrollment of ineligible families.

Recommendation: We recommend the Agency implement written enrollment guidelines and procedures.

Prior Year Status: Lack of effective enrollment guidelines was raised as a finding in the audits of the Agency for fiscal years 1995 through 2001.

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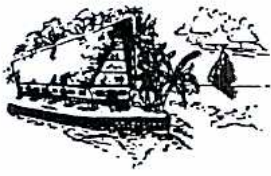
Unresolved Prior Year Findings and Questioned Costs
Year Ended September 30, 2002

Questioned Costs

There are no prior year unresolved questioned costs of the Agency.

Unresolved Prior Year Findings and Questioned Costs

The status of unresolved prior year findings is discussed within the Schedule of Findings and Questioned Costs section of this report (pages 9 through 12).



PALAU COMMUNITY ACTION AGENCY

CHELDELLEL A URREOR-NG-KLUNGIOLEL BELAU

P.O. BOX 3000

KOROR, REPUBLIC OF PALAU 96940

Corrective Action Plans to Questioned Costs and Findings included in the Independent Auditors' Report on Internal Control and Compliance for the Year Ended September 30, 2002

Federal Award Findings and Questioned Costs

Equipment and Real Property Management

Finding No. 2002-1

The auditor's recommendation is being implemented. The Agency's physical inventory for year 2003 is at its final stage. The reconciliation of the physical inventory to property records will be completed prior to October 15, 2003. Finance Officer is responsible to see that physical inventory is reconciled to the property records.

Procurement and Suspension and Debarment

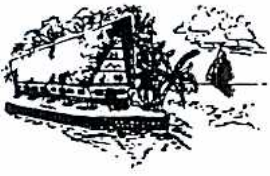
Finding No. 2002-2

The Agency understands the auditor's recommendation. The small purchase procedure is being revised and strengthened to include recording of price analysis done orally.

Eligibility

Finding No. 2002-3

The Agency understands the auditor's recommendation and has reviewed and revised its enrollment guidelines and procedures. The program will verify family income annually and will sign and date the verification form. The Family and Community Services Manager will review all completed application forms, annual income verification forms and sign them for compliance purposes. Applications that lack family annual income verifications will be returned to responsible staff and will not be processed until the income is annualized and verified by Family and Community Service Manager. The Head Start Director is responsible to see that the procedures are being followed and incomes are correctly verified.



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CHELDELLEL A URREOR-NG-KLUNGIOLEL BELAU

P.O. BOX 3000

KOROR, REPUBLIC OF PALAU 96940

Summary of Schedule of Prior Audit Findings

Status of audit findings included in the schedule of findings and questioned costs for the year ended September 30, 2001:

Federal Award Findings and Questioned Costs

Finding No. 2001-1 - Not corrected. See corrective action plan to Finding 2002-1.

Finding No. 2001-2 - Not corrected. See corrective action plan to Finding 2002-3.