

PALAU DISTRICT HOUSING AUTHORITY

**INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS**

Year Ended September 30, 2003

PALAU DISTRICT HOUSING AUTHORITY
(a Public Corporation)

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SEPTEMBER 30, 2003

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Palau District Housing Authority:

We have audited the accompanying combined financial statements of Palau District Housing Authority, (the Authority), a component unit of the Republic of Palau, as set forth in Section I of the foregoing Table of Contents, as of September 30, 2003, and for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Palau District Housing Authority as of September 30, 2003, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the basic financial statements, the Authority adopted the provisions of Governmental Accounting Standards Board Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments", as of October 1, 2002.

The information identified in the accompanying table of contents as *management's discussion and analysis* is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards on page 30 is presented for purposes of additional analysis, as required by the U.S Office of Management and Budget Circular A-133, Audits of States, Local Governments, and Non-profit Organizations. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued my report dated January 16, 2004 on our consideration of Palau District Housing Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with report in considering the results of our audit.

J. Scott Magliari & Company

Koror, Republic of Palau
January 16, 2004

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis September 30, 2003

As management of the Palau District Housing Authority (the Authority) a component unit of the Republic of Palau, we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended September 30, 2003. We encourage readers to consider the information presented here in conjunction with the Authority's financial statements, which begin on page 13.

Financial Highlights

- The assets of the Authority exceeded its liabilities at September 30, 2003 by \$2,316,034 (net assets), an increase of 49.93%.
- The Authority's cash and cash equivalents at September 30, 2003 was \$1,095,985 representing a decrease of \$17,351 from September 30, 2002.
- The Authority had revenues of \$200,933 and expenses of \$148,658 for the year ended September 30, 2003.

Overview of the Financial Statements

The management discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements are comprised of two components: 1) authority-wide financial statements and 2) notes to the financial statements. This report also contains the *Schedule of Expenditures of Federal Awards* as supplementary information in addition to the basic financial statements themselves.

AUTHORITY-WIDE FINANCIAL STATEMENTS

The authority-wide financial statements are designed to provide readers with a broad overview of the Authority's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Overview of the Financial Statements - Continued

AUTHORITY-WIDE FINANCIAL STATEMENTS- Continued

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., depreciation and earned but unused vacation leave).

The *Statement of Cash Flows* provides information about the Authority's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities.

The authority-wide financial statements report on the function of the Authority that is principally supported by intergovernmental revenues. The Authority's function is to develop and administer low-cost housing and urban renewal projects and to assist in correcting housing conditions endangering the health, safety, and welfare of the people residing in the Republic of Palau, which is funded primarily with grant revenue received from the U.S. Department of Housing and Urban Development.

The authority-wide financial statements can be found on pages 13 through 17 of this report.

NOTES TO THE FINANCIAL STATEMENTS

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the authority-wide financial statements. The notes to the financial statements can be found on pages 18 through 25 of this report.

SUPPLEMENTARY INFORMATION

The Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*. The Schedule of Expenditures of Federal Awards can be found on page 30 of this report.

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

FUND FINANCIAL STATEMENTS

Traditional users of governmental financial statements will find the Fund Financial Statements presentation more familiar. The focus is now on Major Funds, rather than fund types. The Authority consists of exclusively Enterprise Funds. Enterprise funds utilize the full accrual basis of accounting. The Enterprise method of accounting is similar to accounting utilized by the private sector accounting.

Many of the funds maintained by the Authority are required by the U.S. Department of Housing and Urban Development. Others are segregated to enhance accountability and control.

Authority-Wide Financial Analysis

Fiscal year 2003 is the first year of implementation of Governmental Accounting Standards Board (GASB) Statement 34. The new financial statement focuses on the Authority as a whole. The Authority financial statements (see pages 13 through 17) are designed to emulate corporate presentation models whereby all Authority activities are consolidated into one total. The focus of the Statement of Net Assets is designed to be similar to bottom line results for the Authority. This statement combines and consolidates current financial resources (short-term spendable resources) with capital assets. The Statement of Revenues, Expenses, and Changes in Net Assets focus on both the gross costs and the net costs of Authority activities which are supported mainly by appropriations from Palau National Congress Olbiil Era Kelulau (OEK) and by other revenues. This approach is intended to summarize and simplify the user's analysis of cost of Authority services to the public.

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Authority-Wide Financial Analysis, Continued

Financial Analysis of the Authority as a Whole
Net Assets
As of September 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
ASSETS		
Current assets:		
Cash and cash equivalents	\$1,095,985	\$1,113,336
Notes receivable, current portion	99,728	122,204
Accounts receivable	34,728	26,348
Interest receivable	<u>10,625</u>	<u>25,226</u>
Total current assets	<u>1,241,066</u>	<u>1,287,114</u>
Noncurrent assets:		
Notes receivable, net of current portion	1,097,600	968,705
Non-current accounts receivable	25,042	25,042
Allowance for doubtful accounts	(169,042)	(169,042)
Due from other funds	1,111,708	1,068,111
Capital assets, net	90,523	84,667
Other assets	<u>75,492</u>	<u>125,484</u>
Total noncurrent assets	<u>2,231,323</u>	<u>2,102,967</u>
TOTAL ASSETS	<u>\$3,472,389</u>	<u>\$3,390,081</u>
LIABILITIES		
Current liabilities:		
Payable to grantor agency	\$ 809	\$ 11,309
Accrued expenses	<u>43,838</u>	<u>56,423</u>
Total current liabilities	<u>44,647</u>	<u>67,732</u>
Due to other funds	<u>1,111,708</u>	<u>1,068,111</u>
TOTAL LIABILITIES	<u>1,156,355</u>	<u>1,135,843</u>

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Authority-Wide Financial Analysis, Continued

	<u>2003</u>	<u>2002</u>
NET ASSETS		
Invested in capital assets	\$ 90,523	\$ 84,667
Restricted	2,312,086	2,312,086
Unrestricted	<u>(86,575)</u>	<u>(142,515)</u>
 TOTAL NET ASSETS	 <u>2,316,034</u>	 <u>2,254,238</u>
 TOTAL LIABILITIES AND NET ASSETS	 <u>\$3,472,389</u>	 <u>\$3,390,081</u>

This schedule is prepared from the Authority's Statement of Net Assets, which is presented on an accrual basis of accounting whereby liabilities and expenses are recorded when incurred, whether or not paid, and revenue is recorded when earned, whether or not received.

Total net assets FY 2003 increased to \$ 2.3 million from \$ 2.2 million in fiscal year 2002. The increase is attributed to increase in notes receivable.

Noncurrent assets increased from \$2.1 million in FY 2002 to \$2.2 million in FY2003. Large portion of the notes receivable is from Home Rehabilitation Loan Program.

Liabilities increased slightly due to an increase in due to other funds.

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the Authority, assets exceeded liabilities by \$2,316,034 at September 30, 2003.

By far the largest portion of the Authority's net assets (99 percent) reflects its restricted net assets. Restricted net assets pertain to grants received from U.S. Department of Housing and Urban Development (HUD), contributions received from the Trust Territory of the Pacific Islands and from the Republic of Palau.

With prudent fund management, the Authority was able to decrease its prior years accumulated deficit from \$142,515 in to FY 2002 to \$86,575 in FY 2003.

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Authority-Wide Financial Analysis, Continued

Statement of Revenues, Expenses, and Changes in Net Assets

**Operating Revenues for the Year Ended
September 30, 2003**

Operating revenues:	
Federal contributions	\$ 43,310
Section 8 income	5,592
Interest on loans	27,627
Republic of Palau appropriations	66,915
National Treasury income	20,500
Other	<u>36,989</u>
Total operating revenues	<u>200,933</u>

The schedule indicates total revenues realized by the Authority in fiscal year 2003 of \$201,000. The largest portion of revenues (\$66,000 and \$20,000) was contributed by the OEK (Palau National Congress). The U.S. Federal Government contributed \$43,310. The Authority's revenues are largely intergovernmental revenues received from cost reimbursement grants. The Authority draws down monies from the grants' awards for allowable program expenses, except for non-cash transactions, such as depreciation expense and changes in compensated absences. The Authority's intergovernmental revenues and charges for services were sufficient to cover all expenses incurred during the year.

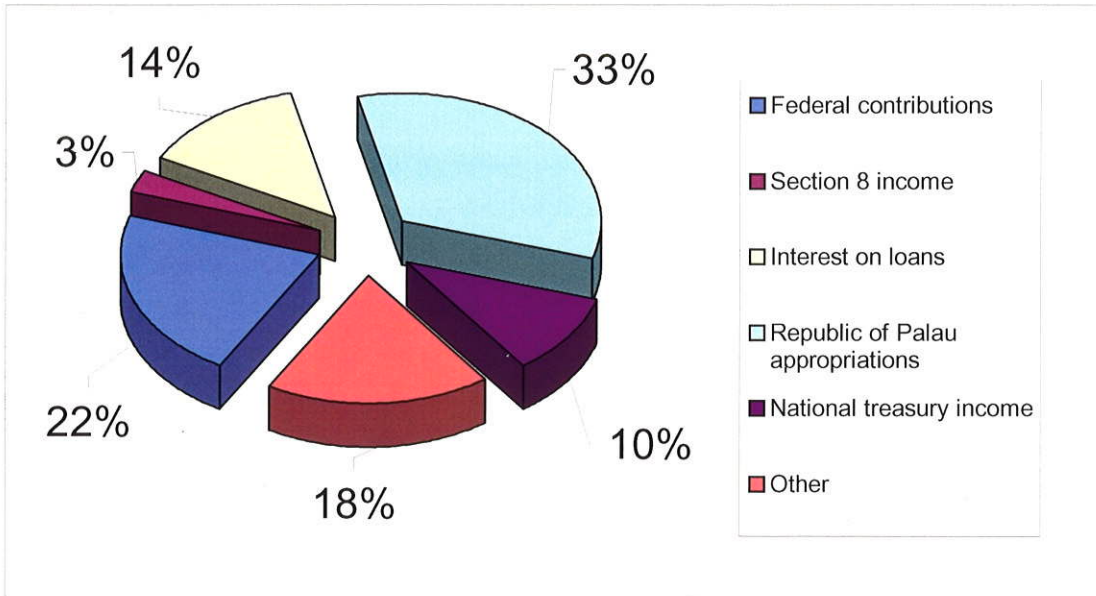
PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Authority-Wide Financial Analysis, Continued

The following chart exhibits the breakdown of revenues for Palau District Housing Authority in fiscal year 2003.

Operating Revenues Break Down



**Operating Expenditures for the Year Ended
September 30, 2003**

Operating expenditures:	
Salaries and wages	\$ 42,959
Professional fees	29,460
Repairs and maintenance	11,595
Rentals	9,350
Employee benefits	4,418
Communications	3,180
Travel	3,154
Other	23,977
Depreciation	<u>20,565</u>
 Total expenditures	 <u>\$ 148,658</u>

PALAU DISTRICT HOUSING AUTHORITY

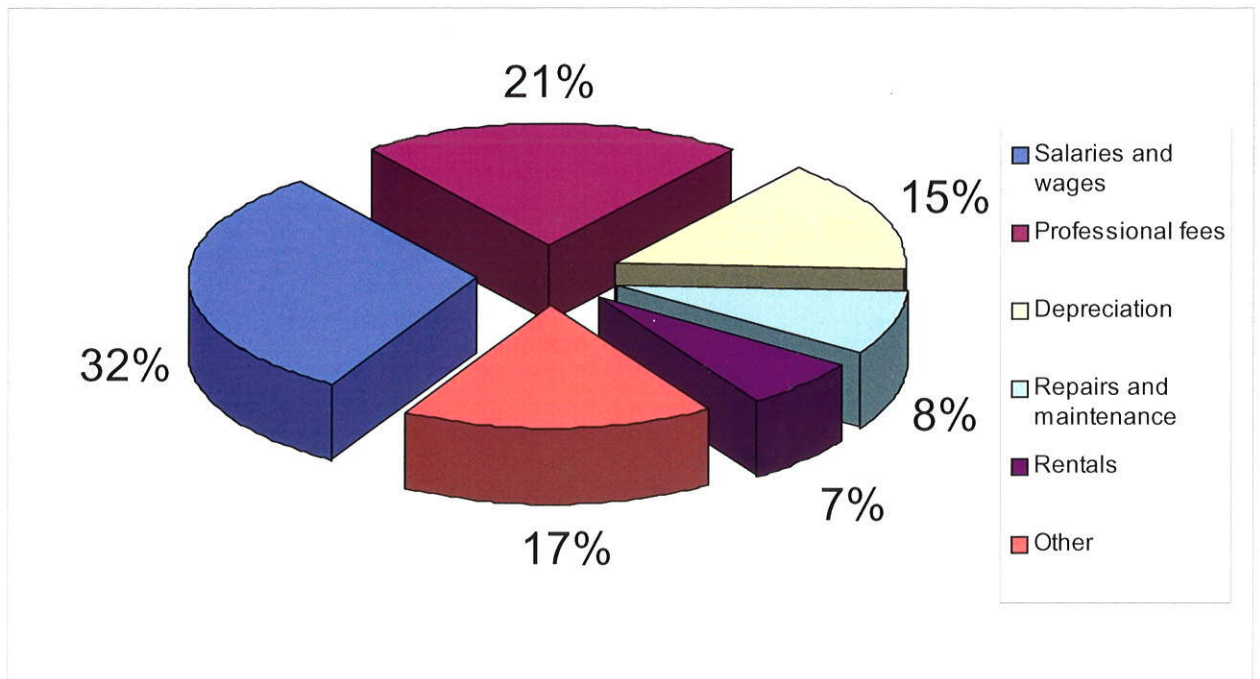
Management's Discussion and Analysis
September 30, 2003

Operating income	\$ 52,275
Non-operating revenues:	
Interest income	<u>9,521</u>
Income before capital contribution	61,796
Capital contribution	<u>2,312,086</u>
Change in net assets	<u>\$ 2,373,882</u>

The above schedule shows the total operating expenditures of \$148,000 in fiscal year 2003. As indicated under income before capital contribution, the Authority in fiscal year 2003 has a surplus of \$62,000. This has enabled the Authority to reduce its prior years' accumulated deficit. The net assets of the Authority increased approximately \$2.3 million during the current fiscal year.

The two (2) biggest expenditures in fiscal year 2003 were salaries and professional fees.

Expenditures Breakdown
For
Year Ended, September 30, 2003



PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

CAPITAL ASSETS

As of September 30, 2003, the Authority's investment in capital assets for its business-type activities was \$90,523 (net of accumulated depreciation) as reflected in the following schedule:

	<u>(Thousands)</u>
Residential units	\$ 214
Furniture, fixtures and equipment	38
Vehicles	28
Accumulated depreciation	<u>(189)</u>
 Total	 <u>\$ 91</u>

Additional information on the Authority's capital assets can be found in Note 5 on page 23 of this report.

Economic Factors and Next Year's Budget and Rates

The following factors were considered in preparing the Authority's budget for the 2004 fiscal year:

- An increase in the collections of loan payments. The increase will be due to additional loan disbursed.
- Appropriation from the Palau National Government applicable to administrative and operation expenditures.
- Rent subsidy from HUD and revenue derived from rental housing units.
-

Future Events that will financially Impact the Authority

The Authority will continue its Rehabilitation Loan Program with expectation of a 20% increase.

The Section 8 HUD program will phase out in December 2004, which will impact the revenues derived from rental units. Plans for the program are being discussed and evaluated in reference to the social and economic impact.

PALAU DISTRICT HOUSING AUTHORITY

Management's Discussion and Analysis
September 30, 2003

Contacting the Authority's Financial Management

The financial report is designed to provide a general overview of the Authority's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Executive Director, Palau District Housing Authority, PO Box 197, Koror, Republic of Palau, 96940, or call (680) 488-6207.

PALAU DISTRICT HOUSING AUTHORITY

Combined Statement of Net Assets with Combining Information
September 30, 2003

	Major Enterprise Funds				
	Total	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds
ASSETS					
Current assets:					
Cash and cash equivalents (Notes 1 and 2)	\$ 1,095,985	\$ 112,266	\$ 647,971	\$ 91,822	\$ 243,926
Notes receivable, current portion (Notes 1, 3 and 8)	99,728	-	84,033	923	14,772
Accounts receivable	34,728	2,198	211	-	32,319
Interest receivable	10,625	-	8,734	1,798	93
Total current assets	1,241,066	114,464	740,949	94,543	291,110
Noncurrent assets:					
Notes receivable, net of current portion (Notes 1, 3 and 8)	1,097,600	-	983,207	24,888	89,505
Non-current accounts receivable	25,042	25,042	-	-	-
Allowance for doubtful accounts (Note 1)	(169,042)	(25,042)	(134,000)	(10,000)	-
	953,600	-	849,207	14,888	89,505
Due from other funds (Notes 1 and 4)	1,111,708	48,558	588,362	257,215	217,573
Capital assets, net (Notes 1 and 5)	90,523	75,652	-	-	14,871
Other assets	75,492	-	75,492	-	-
Total non-current assets	2,231,323	124,210	1,513,061	272,103	321,949
Total assets	\$ 3,472,389	\$ 238,674	\$ 2,254,010	\$ 366,646	\$ 613,059

The accompanying notes are an integral part of these financial statements.

PALAU DISTRICT HOUSING AUTHORITY

Combined Statement of Net Assets with Combining Information, Continued
September 30, 2003

	Major Enterprise Funds				
	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds	Total
LIABILITIES AND NET ASSETS					
Current Liabilities:					
Payable to grantor agency	\$ 809	\$ 809	\$ -	\$ -	\$ -
Accrued expenses	43,838	5,517	21,494	-	16,827
Total current liabilities	44,647	6,326	21,494	-	16,827
Due to other funds (Notes 1 and 4)	1,111,708	139,590	109,163	-	862,955
Total liabilities	1,156,355	145,916	130,657	-	879,782
Net Assets:					
Invested in capital assets (Note 1)	90,523	75,652	-	-	14,871
Restricted (Note 1)	2,312,086	-	1,801,186	260,900	250,000
Unrestricted (Note 1)	(86,575)	17,106	322,167	105,746	(531,594)
Total net assets	2,316,034	92,758	2,123,353	366,646	(266,723)
Commitments and contingencies (Note 8)					
Total liabilities and net assets	\$ 3,472,389	\$ 238,674	\$ 2,254,010	\$ 366,646	\$ 613,059

The accompanying notes are an integral part of these financial statements.

PALAU DISTRICT HOUSING AUTHORITY

Combined Statement of Revenues, Expenses and Changes in Net Assets with Combining Information
 Year Ended September 30, 2003

	Major Enterprise Funds					Non-Major Enterprise Funds
	Total	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program		
Operating revenues:						
Federal contributions	\$ 43,310	\$ 43,310	\$ -	\$ -	\$ -	\$ -
Section 8 income	5,592	5,592	-	-	-	-
Interest on loans	27,627	-	23,693	1,381	2,553	-
Republic of Palau appropriation	66,915	-	-	-	66,915	-
National treasury income	20,500	-	-	-	20,500	-
Other	36,989	21,906	2,713	-	12,370	-
Total operating revenues	200,933	70,808	26,406	1,381	102,338	-
Operating expenditures:						
Salaries and wages	42,959	-	-	-	42,959	-
Professional fees	29,460	-	-	-	29,460	-
Depreciation	20,565	16,116	-	-	4,449	-
Repairs and maintenance	11,595	10,313	-	-	1,282	-
Rentals	9,350	-	-	-	9,350	-
Employee benefits	4,418	-	-	-	4,418	-
Communication	3,180	1,131	-	-	2,049	-
Travel	3,154	-	-	-	3,154	-
Other	23,977	3,322	15,800	-	4,855	-
Total operating expenditures	148,658	30,882	15,800	-	101,976	-
Operating income	52,275	39,926	10,606	1,381	362	-
Non-operating revenues (expenditures):						
Interest income	9,521	457	6,294	802	1,968	-
Other expense	-	-	-	-	-	-
Total non-operating revenues (expenditures), net	9,521	457	6,294	802	1,968	-
Income before capital contributions	61,796	40,383	16,900	2,183	2,330	-
Capital contribution	2,312,086	-	1,801,186	260,900	250,000	-
Change in net assets	2,373,882	40,383	1,818,086	263,083	252,330	-
Total net assets at beginning of year	(57,848)	52,375	305,267	103,563	(519,053)	-
Total net assets at end of year	\$ 2,316,034	\$ 92,758	\$ 2,123,353	\$ 366,646	\$ (266,723)	-

The accompanying notes are an integral part of these financial statements.

PALAU DISTRICT HOUSING AUTHORITY

Combined Statement of Cash Flows with Combining Information
Year Ended September 30, 2003

	Major Enterprise Funds				
	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds	
Cash flows from operating activities:					
Receipts from customers	\$ 248,780	\$ 50,559	\$ 112,627	\$ 1,275	\$ 84,319
Payments to suppliers and employees	(254,240)	(14,702)	(130,794)	-	(108,744)
Other cash receipts (payments)	5,009	11,111	(278)	-	(5,824)
Net cash provided (used) by operating activities	(451)	46,968	(18,445)	1,275	(30,249)
Cash flows from financing activities:					
Acquisition of capital assets	(6,800)	-	-	-	(6,800)
Adjustments on capital assets	(19,621)	(11,629)	440	-	(8,432)
Net cash provided (used) by financing activities	(26,421)	(11,629)	440	-	(15,232)
Cash flows from investing activities:					
Interest and dividends	9,521	457	6,294	802	1,968
Net cash provided by investing activities	9,521	457	6,294	802	1,968
Net increase (decrease) in cash and cash equivalents	(17,351)	35,796	(11,711)	2,077	(43,513)
Cash and cash equivalents at beginning year	1,113,336	76,470	659,682	89,745	287,439
Cash and cash equivalents at end of year	\$ 1,095,985	\$ 112,266	\$ 647,971	\$ 91,822	\$ 243,926

The accompanying notes are an integral part of these financial statements.

PALAU DISTRICT HOUSING AUTHORITY

Combined Statement of Cash Flows with Combining Information, Continued
Year Ended September 30, 2003

	Major Enterprise Funds				
	Total	Section 8 Housing Assistance Program	Home Rehabilitation Loan Program	Low-Cost Housing Program	Non-Major Enterprise Funds
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:					
Operating income	\$ 52,275	\$ 39,926	\$ 10,606	\$ 1,381	\$ 362
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:					
Depreciation	20,565	16,116	-	-	4,449
(Increase) decrease in assets:					
Accounts receivables	(22,952)	962	(211)	-	(23,703)
Receivable from grantor agency	14,573	-	-	-	14,573
Notes receivable	(106,419)	-	(94,116)	924	(13,227)
Interest receivable	14,601	-	15,724	(1,030)	(93)
Due from other funds	(43,597)	(15,983)	(440)	-	(27,174)
Other assets	49,992	-	49,992	-	-
Increase (decrease) in liabilities:					
Payable to grantor agency	(10,500)	-	-	-	(10,500)
Accrued expenses	(12,585)	(21,665)	-	-	9,080
Due to other funds	43,596	27,612	-	-	15,984
Net cash provided (used) by operating activities	\$ (451)	\$ 46,968	\$ (18,445)	\$ 1,275	\$ (30,249)

The accompanying notes are an integral part of these financial statements.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies

The Palau District Authority (the Authority), a component unit of the Republic of Palau, was established by Public Law 4-5-5 (June 20, 1970) of the Palau District Legislature (of the Trust Territory of the Pacific Islands). Its purpose is to develop and administer low cost housing and urban renewal projects and to assist in correcting housing conditions endangering the health, safety, and welfare of the people. The Authority was reorganized by Trust Territory Public Law 5-37 (April 5, 1973). Upon emergence of the Republic of Palau Constitutional Government (January 1, 1981), the Authority was transferred to the Republic. The Authority is a public corporation administered by a five-member Board of Directors appointed by the President of the Republic of Palau with the advice and consent of the Olbiil Era Kelulau (OEK – Palau National Congress).

The Authority's primary operations are comprised of a number of housing and grant programs as follows:

Major Enterprise Funds

Section 8 Housing Assistance Program

The Section 8 Housing Assistance Program has six housing units that are rented to low-income families who lack sufficient income to obtain safe, decent, and sanitary housing. In turn, the U.S. Department of Housing and Urban Development (HUD) makes housing assistance payments to the Authority to defray operating costs.

Home Rehabilitation Loan Program

The Home Rehabilitation Loan Program, initial funding by the HUD under the Community Development Block Grant and through the revolving loan fund continues to make loans to low and moderate-income families for rehabilitating existing dwellings. Loans are available from a minimum of \$500 to a maximum amount of \$30,000, and are to be repaid over 5 to 30 year periods at an interest rate of 4.5 percent per year.

Low-Cost Housing Program

The Trust Territory Government was the Primary source of funds for the Low Cost Housing Program. The Program made loans to low-income families for constructing low cost housing. The maximum amount of a loan is \$12,000, which is payable over 3 to 20-year periods at an interest rate of 3 percent per year.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Non-Major Enterprise Funds

The following funds were determined to be non-major enterprise funds for the year ended September 30, 2003:

The Emergency Housing Revolving Loan Program

The Program was funded by a \$500,000 appropriation from the Republic of Palau. Pursuant to Republic of Palau Public Law 6-26, § 4, the program was established to provide loans to private homeowners whose homes were destroyed or made uninhabitable because of damage done by storm Utor. Loans are available from a minimum of \$500 to a maximum amount of \$30,000, and are to be repaid over 3 to 30 year periods at an interest rate of 3 percent per year. During the fiscal year ending September 30, 2002, the Authority remitted \$250,000 of the initial funding back to the Republic of Palau National Government. Emergency Housing Revolving Loan Program has been established as an Emergency Loan Program for the Republic of Palau to citizens (homeowners) whose homes are destroyed to natural disaster or fire.

Local Funds

Local funds consist of appropriations from Republic of Palau for general operations of the Authority.

Measurement Focus, Basis of Accounting, and Basis of Presentation

During 2003, the Authority implemented GASB Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Government", GASB Statement No. 37, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments: Omnibus", GASB Statement No. 38, "Certain Financial Statement Note Disclosures", and GASB Interpretation No. 6 "Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements."

GASB Statement No. 34 creates new basic financial statements for reporting on the Authority's financial activities. The financial statements now include government-wide financial statements prepared on an accrual basis of accounting and fund accounting financial statements which present information for individual major funds rather than by fund type. Requirements in order to comply also include adopting depreciation on capital assets and classifying assets and liabilities as current and non-current.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

GASB Statement No. 37 clarifies certain provisions of GASB Statement No. 34, including the required content of the Management Discussion and Analysis, the classification of program revenues and the criteria for determining major funds. GASB Statement No. 38 modifies, establishes and rescinds certain financial statement note disclosures. GASB Interpretation No. 6 clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice.

The accounts of the Authority are organized and operated on the basis of funds and grant programs. A fund is an independent fiscal year and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstrating compliance with finance-related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements.

The Authority has elected to use proprietary fund types as its principle reporting. Proprietary funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Authority's proprietary funds are enterprise funds used to account for those operations that are financed and operated in a manner similar to private business or where the Authority has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management accountability.

The general purpose financial statements of the Palau District Housing Authority have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. Government Accounting Standards Board (GASB) Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting", requires that proprietary activities apply all applicable GASB pronouncements as well as Statements and Interpretations issued by the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. The Palau Housing and Urban Renewal Authority has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Budgets – Budgets are prepared on an annual basis for each major operating program and are used as a management tool throughout the accounting cycle. Budgets, however are not legally adopted nor legally required for financial statement presentation.

The Authority's governing body, the Board of Directors, adopts budgets on a program or fund level basis. These budgets are submitted by the Authority's Executive Director, and approved by resolutions of the Board of Directors.

Annual budgets are adopted for all Enterprise Funds. Throughout the fiscal year, the Authority monitors and evaluates expenditures rates and patterns. However, timely notice is not given to executive management regarding forthcoming changes in objectives or other conditions that may cause significant variations from approved budget-defined plans.

The Authority's Board of Directors may authorize revisions to the budget based on the availability of financial resources. Formal budget revisions are authorized in the same manner as original budget submissions.

Management's Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents – For the purposes of the balance sheet and statement of cash flows, the Authority considers cash and cash equivalents to be cash on hand, cash in checking and savings accounts, money market funds, and time certificates of deposit of less than ninety-day maturities. All of the Authority's cash and cash equivalents are with a federally insured bank, \$100,000 of which is subject to coverage by federal insurance with the remaining balance exceeding insurable limits. The Authority does not require collateralization of its bank accounts and, therefore, amounts in excess of insurable limits are uncollateralized.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Loans and Allowance for Loan Losses – Loans are stated at the amount of unpaid principal, reduced by an allowance for loan losses. Interest on loans is calculated by using the simple interest method on daily balances of the principal amount outstanding. The allowance for loan losses is established through a provision for loan losses charged to expenses. Loans are charged against the allowance for loan losses when management believes that the collection of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb possible losses on existing loans that may be uncollectible, based on evaluations of the collectibility of loans and prior loan loss experience. The evaluations take into consideration such factors as specific problem loans and current economic conditions that may affect the borrowers' ability to pay.

Interfund Receivables/Payables – During the course of operations, transactions have occurred between the individual funds and programs. The balances of these receivables/payables at September 30, 2003 are classified as due from other funds or due to other funds on the balance sheet.

Capital Assets and Depreciation – All capital assets with a value greater than \$500 and a useful life over one year are capitalized.

The cost of maintenance and repairs is charged to operations as incurred and improvements are capitalized. Depreciation of capital assets is computed using the straight-line method over the estimated useful lives of the assets. Assets are depreciated using the following depreciation guidelines:

<u>Category</u>	<u>Useful Life - Years</u>
Residential units	28
Furniture, fixtures and equipment	5
Vehicles	5

Upon retirement or other disposition of capital assets recorded, the cost and related accumulated depreciation are removed from the respective program's or fund's accounts and any gain or loss is included in the respective program's or fund's current operations.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(1) Summary of Significant Accounting Policies, Continued

Measurement Focus, Basis of Accounting, and Basis of Presentation, Continued

Compensated Absences – Compensated absences are those absences for which employees will be paid, such as vacation and sick leave. Employees are credited 55, 208 or 280 hours per fiscal year, based on their lengths of service. The accumulation of vacation and sick credits is limited to 360 hours at fiscal year-end and is convertible to pay upon termination of employment. The Authority recognizes as a liability all vested vacation and sick leave benefits accrued by its employees. When the employees use vacation and sick leave benefits, the liability account is reduced accordingly. As of September 30, 2003, compensated absences payable totaled \$755.

Notes Receivable – The Authority recognizes bad debts using the allowance method and are only written-off after approval by management and subsequent reporting to the Board of Directors.

Income Tax - Based on 34 PNC 7006, the Authority is exempt from all national and state non-payroll taxes or fees.

Net Assets - The Authority's net assets are classified as follows:

Invested in capital assets - This represents the Authority's total investment in capital assets, net of accumulated depreciation.

Restricted net assets – This includes grants from HUD and contributions received from the Trust Territory of the Pacific Islands for the establishment of the Home Rehabilitation Revolving Loan Program and the Low-Cost Housing Revolving Loan program, respectively. It includes also contributions received from the Republic of Palau National Government for the establishment of Emergency Loan Program.

Unrestricted net assets – This includes resources derived from government appropriations. These resources are used for transactions relating to the general operations of the Authority and may be used at the discretion of the governing board to meet current expenses for any purpose.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(2) Cash and cash equivalents

Cash and cash equivalents at September 30, 2003 consist of the following:

Cash	\$ 349,835
Time certificates of deposit	639,199
Money market account	<u>106,951</u>
	<u>\$ 1,095,985</u>

(3) Notes Receivable

The Authority makes loans to qualifying residents of the Republic of Palau for rehabilitating existing dwellings or for constructing approved low-cost housing. The loans have terms from five to thirty years in duration at an interest rate of 4.5%. Loans are restricted to a maximum ninety percent (90%) debt (aggregate of all debts associated with the property) to the appraised value of the property ratio or ninety percent (90%) of the estimated replacement cost, whichever is lower. The loans are collateralized by the property being rehabilitated.

A summary of notes receivable at September 30, 2003 follows:

Home Rehabilitation loans	\$ 1,067,240
Emergency Loan Revolving Fund	104,277
Low-Cost Housing loans	<u>25,811</u>
	1,197,328
Less: Amounts due within one year	<u>99,728</u>
Long-term portion of notes receivable	1,097,600
Allowance for loan losses	<u>(144,000)</u>
Net loans	<u>\$ 953,600</u>

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(4) Interfund Receivable/Payable Accounts

The Authority maintains interfund receivable and payable accounts for all housing projects and funds that it administers. Balances at September 30, 2003 are comprised as follows:

	<u>Due from other Funds</u>	<u>Due to other Funds</u>	<u>Net Receivable (Payable)</u>
Home Rehabilitation Loan	\$ 588,362	\$ 109,163	\$ 479,199
Section 8 Housing Assistance Program	48,558	139,591	(91,033)
Low-Cost Housing Loans	257,215	-	257,215
Non-Major Enterprise Funds	<u>217,573</u>	<u>862,954</u>	<u>(645,381)</u>
Net Interfund balances	<u>\$ 1,111,708</u>	<u>\$ 1,111,708</u>	<u>\$ -</u>

(5) Capital Assets

A following is a summary of changes in capital assets for the year ended September 30, 2003:

	<u>Balance 9/30/02</u>	<u>Additions</u>	<u>Disposal</u>	<u>Other Adjustments</u>	<u>Balance 9/30/03</u>
Residential units	\$ 213,431	\$ -	\$ -	\$ -	\$213,431
Furniture, Fixtures and Equipment	44,040	-	(560)	(5,039)	38,441
Vehicles	<u>21,995</u>	<u>6,800</u>	<u>-</u>	<u>(1,000)</u>	<u>27,795</u>
	279,466	6,800	(560)	(6,039)	279,667
Less: Accumulated depreciation	<u>(194,799)</u>	<u>20,564</u>	<u>(560)</u>	<u>(25,660)</u>	<u>(189,143)</u>
Net Capital Assets	<u>\$ 84,667</u>	<u>\$ (13,764)</u>	<u>\$ -</u>	<u>\$ 19,621</u>	<u>\$ 90,524</u>

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(5) Capital Assets, continued

The residential units were constructed on properties initially leased from the Trust Territory Government, which were transferred to Palau Public Land Authority in accordance with U.S. Department of the Interior Secretarial Order No. 2969. The properties were subsequently transferred to the Koror Municipal Public Lands Authority through quitclaim deeds dated May 14, 1980 and February 16, 1983. Upon termination of the lease agreement (December 31, 2006), all improvements on the properties shall become the properties of the lessor or its successor.

(6) Employees Retirement Plan

The Authority contributes to the Palau Civil Service Pension Trust Fund (the Fund), a defined benefit, cost-sharing, multi-employer pension plan established and administered by the Republic of Palau. The Fund issues a stand-alone financial report which is available at its office site.

The Fund provides retirement, security and other benefits to employees, and their spouses and dependents, of the Republic of Palau State Governments and Republic of Palau agencies, funds and public corporations, which are paid monthly and are two percent of each member's average monthly salary. Normal benefits are the credited total service up to a maximum of thirty years total service. Generally, benefits vest after three years of credited service. Members, who retire at or after age 60, or with 30 years of vesting service, are entitled to retirement benefits. Republic of Palau Public Law 2-26 is the authority under which benefit provisions and contributions rates are established.

Member contribution rates are established by Republic of Palau Public Law 2-26 at six percent (6%) of total payroll and are matched dollar for dollar by the employer.

The Authority contributed \$2,513 and \$2,183 to the Fund during fiscal years 2003 and 2002, respectively, which represent 100% of the Authority's required contribution for the respective fiscal years.

Under the provisions of the Republic of Palau Public Law 2-26, the Fund's Board of Trustees adopted a Trust Fund Operation which has the force and effect of law, and which sets forth the procedures for the administration and coverage of the Plan. Amendments to the Plan are subject to the requirements of Title 6 of the Palau National Code. The Authority's total payroll for fiscal years 2002 and 2001 which amounted to \$42,959 and \$40,968, respectively, is covered by the Fund's plan.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(6) Employees Retirement Plan, Continued

The Fund utilizes the actuarial cost method termed "entry age normal cost" with actuarial assumptions used to compute the pension benefit obligation. The following is the statement of actuarial assumptions for the year October 1, 1999 to September 30, 2000 of the ROP Civil Service Pension Plan:

Actuarial Cost Method: Aggregate Cost Method	
Interest Rates	: Pre-retirement rate: 10.0%
	Post-retirement: 10.0%
Mortality Rates	: Pre-retirement: 10.0%
Salary Increases	: 3%
Withdrawal Rates	: None
Disability Rates	: None
Retirement	: Members are assumed to retire at their normal retirement date

The pension benefit obligation, which is the actuarial present value of credited projected benefits, is a standardized disclosure measure of the present value of pension benefits, adjusted for the affects of projected salary increases and any step-rate benefits, estimated to be payable in the future as a result of employment service to date. The measure is intended to assist users to evaluate the Fund's funding status on a going-concern basis, and evaluate progress made in accumulating adequate assets to pay benefits when due.

The Fund's revised October 1, 1999 actuarial valuation determined the unfunded pension benefit obligation as follows:

Present value of accrued benefits, 10/1/99	
Active participants	\$ 25,917,335
Benefits in payment	28,241,213
Vested deferred benefits	998,820
Active employees	1,754,801
Terminated employees	<u>1,004,334</u>
Total pension benefit obligation	57,916,503
New assets available for benefits, at market value	<u>31,093,274</u>
Unfunded benefit obligation	<u>\$ 26,823,229</u>
Funded Ration as of 10/1/1999 (ratio of assets to liabilities)	<u>53.69%</u>

PALAU DISTRICT HOUSING AUTHORITY

Notes to Combined Financial Statements
September 30, 2003

(7) Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions, injuries to employees; and natural disasters. The Authority has elected to be self-insured for the risks of loss to which it is exposed.

(8) Commitments and Contingencies

The Board of Directors of the Authority approved Rehabilitation Loan Program aggregating to \$250,000, of which none was un-disbursed as of September 30, 2003.

The Authority's operations fund has a deficit and has liabilities due to other funds of \$569,863 at September 30, 2003. Furthermore, a substantial portion of the Authority's funding is provided by grants from HUD. Therefore, the future of the entity is contingent upon the Authority's ability to continue to receive grant funding and to achieve significant improvements in operations.

Litigation

The Authority is subject to various claims and other legal actions in the normal course of business. Palau District Housing Authority consults their legal counsel and the Office of the Attorney General of the Republic of Palau whenever there is a potential or asserted claim, and relies on the advice of counsel for direction and for establishing reserves for potential unfavorable outcomes.

The Authority has initiated several foreclosure actions now pending in the Trial Division of the Supreme Court of Palau against twelve (12) borrowers who have defaulted on rehabilitation loans whose principle and interest balance approximate \$107,712 as of September 30, 2003. The Authority intends to take the following courses of action with respect to these matters: (1) renegotiate the loan; (2) pursue the claim in court to recover the amount through judgments for monetary awards; or (3) pursue the claim in court to recover the amount through judgments for foreclosure on mortgaged properties.

(9) Certain Reclassifications

Certain reclassifications have been made to the prior year's financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or retained earnings.

PALAU DISTRICT HOUSING AUTHORITY

**INDEPENDENT AUDITOR'S REPORTS ON
INTERNAL CONTROL AND ON COMPLIANCE**

YEAR ENDED SEPTEMBER 30, 2003

**INDEPENDENT AUDITOR'S 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 District Housing Authority:

We have audited the basic financial statements of the Palau District Housing Authority (the Authority), as of and for the year ended September 30, 2003, and have issued our report thereon dated January 16, 2004. We have 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 Authority's basic financial statements are free of material misstatement, we performed tests of its compliance with certain provision 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 Authority'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.

This report is intended for the information of management, the Board of Directors, federal awarding agencies and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

J. Scott Magliani & Company

Koror, Republic of Palau
January 16, 2004

Internal Control Over Compliance

The management of the Authority 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 Authority'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.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control 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 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. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the basic financial statements of the Authority as of and for the year ended September 30, 2003, and have issued our report thereon dated January 16, 2004. Our audit was performed for the purpose of forming and opinion on the financial statements taken as a whole. The accompanying Schedule of Expenditures of Federal Awards (see page 33) 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 Authority. 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 for the information of management, the Board of Directors, federal awarding agencies and the cognizant audit and other federal agencies. However, this report is a matter of public record and its distribution is not limited.

J. Scott Magliari + Company

Koror, Republic of Palau
January 16, 2004

PALAU DISTRICT HOUSING AUTHORITY

Schedule of Expenditures of Federal Awards
Year Ended September 30, 2003

Grantor/Account Title	Grant/ Contract I.D.#	CFDA No.	Total Authorizations	Prior Years Expenses	FY2003 Expenses/ Revenues	Total Program Expenses	Excess (Deficit) Authorization over Program Expenses
<u>U.S. Department of Housing and Urban Development</u>							
Community Development Block Grant							
- Insular Area:							
Meyuns Elementary School	B-86-ST-70-0001	14.225	\$ 179,256	\$ 179,256	\$	\$ 179,256	\$ -
Home Rehabilitation Loan Program	B-88-ST-70-0001	14.225	165,510	165,510		165,510	-
Ibobang Dock	B-88-ST-70-0001	14.225	80,234	80,234		80,234	-
Ollie Community Center	B-89-ST-70-0001	14.225	120,000	120,000		120,000	-
Ngeremlengui Elementary School	B-89-ST-70-0001	14.225	180,000	180,000		180,000	-
Iyebuki Community Center	B-94-ST-70-0001	14.225	100,000	100,000		100,000	-
Pelefiu Old Age Center	B-94-ST-70-0001	14.225	150,000	150,000		150,000	-
General Program Administration	B-94-ST-70-0001	14.225	47,500	47,500		47,500	-
Emergency Shelter Transitional Home	B-95-ST-70-0001	14.225	45,000	45,000		45,000	-
Palau High School Toilet Facility	B-95-ST-70-0001	14.225	50,000	50,000		50,000	-
Meyuns Community Center	B-95-ST-70-0001	14.225	70,000	70,000		70,000	-
Meyuns Parking			5,000	5,000		5,000	-
Pelefiu Elementary School Cafeteria	B-95-ST-70-0001	14.225	120,000	120,000		120,000	-
General Program Administration	B-95-ST-70-0001	14.225	42,500	42,500		42,500	-
Rehabilitation Loan Administration	B-95-ST-70-0001	14.225	30,000	30,000		30,000	-
Rehabilitation Loan Program	B-96-ST-70-0001	14.225	180,000	180,000		180,000	-
Rehabilitation Loan Administration	B-96-ST-70-0001	14.225	33,000	33,000		33,000	-
General Program Administration	B-96-ST-70-0001	14.225	20,000	20,000		20,000	-
Ngerusar Community Center	B-97-ST-70-0001	14.225	106,000	106,000		106,000	-
Rehabilitation Loan Administration	B-97-ST-70-0001	14.225	20,000	20,000		20,000	-
General Program Administration	B-97-ST-70-0001	14.225	30,000	30,000		30,000	-
Melekeok State Gym	B-98-ST-70-0001	14.225	42,400	42,400		42,400	-
Rehabilitation Loan Administration	B-98-ST-70-0001	14.225	20,000	20,000		20,000	-
General Program Administration	B-98-ST-70-0001	14.225	15,600	15,600		15,600	-
			1,852,000	1,852,000		1,852,000	-
Emergency Shelter Grant	S-94-DC-70-0001	14.231	10,000	10,000		10,000	-
Emergency Shelter Grant	S-95-DC-70-0001	14.231	14,000	14,000		14,000	-
Emergency Shelter Grant	S-96-DC-70-0001	14.231	9,000	9,000		9,000	-
Emergency Shelter Grant	S-97-DC-70-0001	14.231	8,000	8,000		8,000	-
Emergency Shelter Grant	S-98-DC-70-0001	14.231	7,000	7,000		7,000	-
			<u>\$ 1,900,000</u>	<u>\$ 1,900,000</u>		<u>\$ 1,900,000</u>	<u>\$ -</u>
Section 8 Housing Assistance Payments Program	SF-78-192	14.856			43,310		
Total federal financial assistance					<u>\$ 43,310</u>		

See accompanying notes to schedule of expenditures of federal awards.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Schedule of Expenditures of Federal Awards Year Ended September 30, 2003

(1) Scope of Review

The Palau District Housing Authority (the Authority) is a component unit of the Republic of Palau. The Authority was established by Public Law 4-5-5 of the Palau District Legislature of the Trust Territory of the Pacific Islands and subsequently reorganized by Trust Territory Public Law 5-37. Upon emergence of the Republic of Palau Constitutional Government, the Authority was transferred to the Republic.

The purpose of the Authority is to develop and administer low cost housing and urban renewal projects and to assist in correcting housing conditions endangering the health, safety, and welfare of the people through low interest loans.

The accompanying Schedule of Expenditures of Federal Awards presents federal programs related to the U.S. Department of Housing and Urban Development (HUD), administered by the Authority. The U.S. Department of the Interior has been designated as the Authority's cognizant agency for the OMB Circular A-133 audit.

(2) Summary of Significant Accounting Policies

A. 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 authorizations of expenses of the individual programs. All authorizations represent the total allotment or grant award received. All expenses and capital outlays are reported as expenses.

B. Indirect Cost Allocation

The Authority does not currently have an approved indirect cost allocation plan.

PALAU DISTRICT HOUSING AUTHORITY

Notes to Schedule of Expenditures of Federal Awards
Year Ended September 30, 2003

(2) Summary of Significant Accounting Policies, continued

C. Federal Programs

The following federal program was received in a direct capacity from HUD:

Section 8 Housing Assistance Payments Program CFDA # 14.856

The Authority administers a "Home rehabilitation Loan Program" funded originally by sub-grants from the Republic of Palau under the HUD Community Development Block Grant – Insular Area (CFDA # 14.225). The total value of the loan portfolio, net of allowance for loan losses of \$134,000, amounted to \$933,240 as of September 30, 2003 and is included in the determination of a major program.

**INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE
WITH SPECIFIC REQUIREMENTS APPLICABLE TO
AFFIRMATIVE FAIR HOUSING AND NON-DISCRIMINATION**

To the Board of Directors
Palau District Housing Authority:

We have audited the financial statements of the Palau District Housing Authority ("the Authority"), a component unit of the Republic of Palau, as of and for the year ended September 30, 2003 and have issued our report thereon dated January 16, 2004.

We have applied procedures to test the Authority's compliance with the Affirmative Fair Housing and Non-Discrimination requirements applicable to its HUD assisted programs, for the year ended September 30, 2003.

Our procedures were limited to the applicable compliance requirements described in the Consolidated Audit Guide for Audits of HUD Programs issued by the U.S. Department of Housing and Urban Development, Office of Inspector General. Our procedures were substantially less in scope than an audit, the objective of which would be the expression of an opinion on the Authority's compliance with the Affirmative Fair Housing and Non-Discrimination requirements. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance with the Affirmative Fair Housing and Non-Discrimination requirements.

This report is intended for the information of the Board of Directors, management, and the Department of Housing and Urban Development. However, this report is a matter of public record and its distribution is not limited.

J. Scott Magliari + Company

Koror, Republic of Palau
January 16, 2004

PALAU DISTRICT HOUSING AUTHORITY

Schedule of Findings and Questioned Costs September 30, 2003

Part I – Summary of Auditor’s Results

Audit of Financial Statements

1. The Independent Auditor’s Report on the financial statements of Authority expressed an unqualified opinion.
2. There were no reportable conditions required to be disclosed by *Government Auditing Standards* issued by the Comptroller General of the United States.
3. There were no instances of noncompliance considered material, as defined by the Government Auditing Standards, in the financial statement.

Audit of Federal Awards

4. There were no reportable conditions required to be disclosed by OMB Circular No. A-133.
5. The Independent Auditor’s Report on compliance requirements applicable to major federal award programs for Authority expressed an unqualified opinion.
6. The audit disclosed no audit findings, which the auditor is required to report under OMB Circular No. A-133, Section 510 (a).
7. The Authority’s one major program was Community Development Block Grant – Insular Area CFDA # 14.225.
8. A threshold of \$300,000 was used to distinguish between Type A and B programs as those terms defined in OMB Circular A-133.
9. The Authority did not qualify as a low-risk auditee pursuant to OMB Circular A-133.

Part II – Findings on Financial Statements

There were no reportable findings noted concerning financial statements audit.

Part III – Findings on Federal Awards

There were no reportable findings or questioned costs noted concerning federal awards.

PALAU DISTRICT HOUSING AUTHORITY
Schedule of Prior Year Audit Findings
Year Ended September 30, 2003

Finding No. 02-1

Condition: The Authority is not accruing federal grant revenue based on expenses incurred.

Recommendation: We recommend that Authority establish and implement written policies and procedures to ensure that federal grant revenues are accrued based on related expenses incurred.

Current Status: Resolved. The Authority had taken the necessary steps to address this condition by installing and implementing Peachtree accounting software in recording the transactions. The Authority has been able to recognize revenue when earned and measurable.

Finding No. 02-2

Condition: Management did not perform a review of the adequacy of the allowance for doubtful accounts during the fiscal year. We noted that the Authority had approximately \$163,000 of delinquent loans outstanding as of September 30, 2002. However, subsequent to September 30, 2002, management increased its collection efforts to bring all delinquent accounts current and forwarded numerous accounts to its attorney for collection. Consequently, no audit adjustment was made to increase the allowance for doubtful accounts.

Recommendation: We recommend that Authority establish and implement written collection policies and procedures as well as policies governing the review and evaluation of the adequacy of the allowance for doubtful accounts to ensure that the Authority's credit risk is properly assessed and monitored. All delinquent account borrowers should be contacted and aggressively pursued to determine collectibility of loan receivables.

Current Status: Resolved. The Authority has taken steps to aggressively pursue all delinquent loans receivable. The Authority currently has implemented a collection policy and internal control loan servicing policies and procedures to ensure that the Authority's credit risk is properly assessed and monitored. These policies and procedures outline detailed steps monitoring and identifying potential delinquent accounts to when an account is ultimately referred to the Attorney General's Office for collection and/or foreclosure, if necessary. The Authority performs a periodic review and evaluation of its doubtful accounts.

PALAU DISTRICT HOUSING AUTHORITY

Schedule of Prior Year Audit Findings

Year Ended September 30, 2003

Finding No. 02-3

Condition: Reconciliation of the loan and individual ledgers was not conducted for the Rehabilitation Loan Receivable during fiscal year 2002. I noted that the general ledger was over-stated by \$8,757 at September 30, 2002. However, prior to commencement and completion of my audit, the Authority reconciled and adjusted the general ledger control account.

Recommendation: I recommend that Authority establish and implement written policies and procedures to ensure that subsidiary ledgers are reconciled to general ledger controls on a monthly basis.

Current Status: Resolved. The overstated amount has been carried over since fiscal year 2000. The Authority has been reconciling the general ledger loan balances to subsidiary ledgers on a monthly basis.

Finding No. 02-4

Condition: During our review of non-recurring journal vouchers posted to the general ledger throughout the year, we noted that numerous journal entries were prepared and approved by the initiator of the journal voucher. In many instances, staff accountants were preparing, approving and posting journal entries to the general ledger. Numerous journal vouchers lacked supporting documentation to substantiate transactions. Upon further inquiry, we were able to obtain such supporting documentation; however, there is no assurance that all journal vouchers are independently reviewed, approved and properly supported by underlying documentation.

Recommendation: We recommend that the Authority establish and implement internal control policies and procedures to ensure that all journal vouchers are independently reviewed and approved by persons other than the preparator prior to posting in the general ledger. This review and approval should be documented on the journal voucher. Additionally, all journal vouchers should be supported by sufficient documentation to substantiate the transaction, which should be attached to the journal voucher.

Current Status: Resolved. The Authority has taken the necessary steps and implemented internal control policies and procedures to address this condition. We noted that journal vouchers are now supported by sufficient evidential documentation to substantiate transactions and such are properly reviewed and approved by management prior to posting.

PALAU DISTRICT HOUSING AUTHORITY
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Finding No. 02-5

Condition: We commend management's efforts of performing detail review of all loans and I noted substantial improvements in the loan files tested. However, our audit of the loan accounts revealed the following:

- a. Section B, item 12 of the General Provisions of the Rehabilitation Loan Program requires that contractor provide the Authority a performance bond of not less than 100% of the contract price. Such was neither obtained nor waived by the Authority.
- b. Section B, item 13 of the General Provisions of the Rehabilitation Loan Program requires the contractor to procure and maintain insurance coverage of not less than 50% for any one accident or occurrence. A copy of the insurance policy obtained by the Authority to ensure that compliance with this requirement.
- c. For Loan number 00-273, we found a stale dated check in the amount of \$800 from a contractual that was neither deposited nor returned to the contractor by the Authority.

Recommendation: Management should continue its efforts to review all loan files for completeness to ensure that all loans contain appropriate documentation in accordance with its loan policies and procedures. We recommend that Authority review its existing loan approval process, and loan closeout procedures to ensure that loan accounts are properly updated in a timely manner. The Authority should establish a document checklist to ensure all required documentation is properly obtained prior to loan closeout. All loan files should be reviewed to ensure that all required documents are properly recorded with the Clerk of the Court and registered with the Land Court.

Current Status: Resolved. The Authority has implemented the above recommendation and has considered this finding closed.

PALAU DISTRICT HOUSING AUTHORITY
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Finding No. 02-6

Condition: For one of nineteen or 53% of the loan files tested, we noted that for loan file number 02-010, the contract was not properly signed and executed prior to commencement of construction.

Recommendation: Management should review all loan files for completeness to ensure that all loans contain appropriate documentation in accordance with its loan policies and procedures. The Authority should establish a document checklist to ensure all required documentation is properly obtained prior to loan closeout.

Current Status: Resolved. The Authority has corrected this finding. Contractual revisions were made and a new contract was written for the borrower's signature, which was subsequently obtained.

Finding No. 02-7

Condition: For one of twenty-five or 13% cash receipts tested for the Home Rehabilitation Loan Program, we found that cash receipts totaling \$270 was not properly deposited to the bank in a timely manner, while the customer statement and general ledger reflected the receipt of payment.

Additionally, for one of nineteen or 53% of the cash receipts tested for the Emergency Housing Revolving Loan, we found that cash receipts totaling \$70 was not properly deposited to the bank in a timely manner, while the customer statement and general ledger reflected the receipt of payment.

Recommendation: Management should investigate the above condition to determine whether the funds were properly accounted for. The Authority should establish and implement internal control policies and procedures to segregate the receiving cash collections, making bank deposits, bank reconciliations and customer subsidiary and general ledger posting. Daily collections should be independently reviewed and approved prior to being deposited in the bank. The Daily Collection Report should be independently reviewed and compared with the customer receipts issued and monies collected to ensure that daily collections are properly accounted for prior to bank deposit.

Current Status: Resolved. The Authority has implemented internal control policies and procedures to ensure that cash handling procedures are properly segregated. The Authority was able to successfully investigate and recover the above-mentioned monies.

PALAU DISTRICT HOUSING AUTHORITY

Schedule of Prior Year Audit Findings

Year Ended September 30, 2003

Finding No. 02-8

Condition: We commend management's efforts to conduct a physical verification of assets owned by the Authority. However, based on our audit of fixed assets and attendant records, the following weaknesses were noted:

- a. The Authority does not maintain policies or procedures in place for identifying, maintaining, or disposing of fully depreciated, idle or damaged fixed assets.
- b. Assets acquired with federal funds are not specifically identified as to the federal funding source.
- c. Depreciation and accumulated depreciation was not properly recorded for fiscal year 2002. However, this condition was corrected by a proposed audit adjustment.
- d. The Authority does not have a formal capitalization policy that sets forth the dollar threshold for capitalizing versus expensing fixed asset purchases.

Recommendation: We recommend that Authority establish and implement written policies and procedures to ensure that fixed assets are properly accounted for pursuant to the Common Rule for Uniform Administrative Requirements for Grants and Cooperative Agreements with States and Local Governments. Additionally, the Authority should develop and adopt a capitalization policy for fixed assets.

Current Status: Resolved. The Authority has performed a physical verification of all assets and has created a form that details each asset. The accounting software used by the Authority allows it to maintain a fixed asset continuity schedule showing all assets and monthly depreciation expense and accumulated depreciation.

PALAU DISTRICT HOUSING AUTHORITY

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Finding No. 02-9

Condition: We noted that the Authority was not properly recording transactions to the general ledger in a timely manner. Program expenditures were not being reconciled between the funds and financial statements were not being timely prepared. Currently, the Authority is using a database for its general ledger rather than a double-entry accounting software system. Consequently, nearly all of the general accounts were not properly reconciled during the year ending September 30, 2002 and required significant adjustment to correct erroneous posting and unrecorded transactions.

We also noted that the Authority continues to maintain various electronic and manual financial databases and sub-systems to augment its existing accounting software. These databases and subsystems are cumbersome and redundant, resulting in an inefficient and ineffective financial management reporting system.

Furthermore, we noted that the Authority maintains a database for its loan portfolio to track loan payments, interest receivable calculations, outstanding balances etc. This database system is prone to errors and does not provide historical information if not backed-up on a monthly basis. To supplement this database, the Authority maintains manual subsidiary ledger cards to track borrowers' payment and outstanding balances.

Recommendation: We recommend that the Authority hire trained and experienced accountant to maintain its accounting records. Additionally, the Authority should establish and implement a financial management system to reflect a financial information classification structure, which provides for tracking of specific program expenditures and covers financial and financially related information. This structure should minimize data redundancy, ensure that consistent information is collected for similar transactions throughout the Authority, encourage consistent formats for entering data directly into the FMS, and ensure that consistent information is readily available and provided to program managers with the organization. The FMS's design should support the Authority's budget, accounting, and financial management reporting processes by providing consistent information for budget formulation, budget execution, programmatic and financial management, performance measurement and financial statement preparation. Further, I recommend that existing accounting and financial processes be examined to reduce redundancies and duplication of efforts performed in order to streamline workflow to enhance financial operations and employee performance.

Current Status: Resolved. The new accounting software has been implemented to support the financial management system in an effective and efficient manner.