PALAU INTERNATIONAL CORAL REEF CENTER
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

INDEPENDENT AUDITORS’ REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2011
INDEPENDENT AUDITORS’ REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Directors
Palau International Coral Reef Center:

We have audited the financial statements of the Palau International Coral Reef Center (the Center) as of and for the year ended September 30, 2011, and have issued our report thereon dated February 25, 2013. 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.

Internal Control Over Financial Reporting

Management of the Center is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Center’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Center’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Center’s internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting, described in the accompanying Schedule of Findings and Responses (pages 3 and 4) as items 2011-1 and 2011-2 that we consider to be significant deficiencies in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 one instance of noncompliance or other matters that is required to be reported under Government Auditing Standards and which is described in the accompanying Schedule of Findings and Responses as item 2011-1.

We noted certain matters that we reported to management of the Center in a separate letter dated February 25, 2013.

The Center’s responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Center’s responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

[Signature]

February 25, 2013
Deferred Revenue

Finding No. 2011-1

Criteria: Grant funds received should be used for purposes stipulated in the grant agreement.

Condition: The Center has deferred revenue of $120,370 related to grant funds received and has internally restricted cash of $141,736 at September 30, 2011. Significant deferred revenue balances are as follows:

<table>
<thead>
<tr>
<th>Grant Name</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund 903A: UNESCO - Education 2011</td>
<td>$16,599</td>
</tr>
<tr>
<td>Fund 253B: Packard MPA</td>
<td>$34,986</td>
</tr>
</tbody>
</table>

Cause: The cause of the above condition is the potential use of grant funds for purposes unrelated to the grant.

Effect: The effect of the above condition is the potential violation of grant terms and conditions.

Recommendation: We recommend that the Center establish policies and procedures to ensure grant monies are used for purposes stipulated in the grant agreement and that unexpended grant funds are monitored.

Prior Year Status: The lack of policies and procedures in monitoring the use of grant monies was reported as a finding in the audits of the Center for fiscal years 2007 through 2010.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Mingrang Kloulechad

Corrective Action Plan: We hired a Business Manager who has experience in grant management. At the same time, we have set-up a system to recognize grant revenues when allowable expenses are incurred.

Proposed Completion Date: Fiscal year 2013
External Financial Reporting

Finding No. 2011-2

Criteria: Grant revenues should be recognized when allowable expenses are incurred.

Condition: Grant revenues differed from grant expenses by $46,280 during the year ended September 30, 2011. This condition was corrected through a proposed audit adjustment.

Cause: The cause of the above condition is the lack of proper recognition of grant revenues.

Effect: The effect of the above condition is a misstatement of grant revenues.

Recommendation: We recommend that the Center ensure that grant revenues are recognized when allowable expenses are incurred.

Prior Year Status: The lack of proper recognition of grant revenues was reported as a finding in the audit of the Center for fiscal year 2010.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Mingrang Kloulechad

Corrective Action Plan: Adjustments have been made to correct fiscal year 2012. The system has been set-up to recognize grant revenues when allowable expenses are incurred.

Proposed Completion Date: Fiscal year 2012
The status of unresolved prior year internal control findings is disclosed within the Schedule of Findings and Responses section of this report (pages 3 and 4).