



OFFICE OF THE PUBLIC AUDITOR
REPUBLIC OF PALAU

PERFORMANCE AUDIT REPORT

ON



MELEKEOK STATE GOVERNMENT
REPUBLIC OF PALAU

PERIOD COVERED

OCTOBER 1, 2008 THROUGH SEPTEMBER 30, 2012

Performed by the Office of the Public Auditor

MEL09-12-P03*opa20

REPUBLIC OF PALAU



Office of the Public Auditor

November 18, 2014

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Honorable Aloisius Tellei
Governor
Melekeok State Government
Office of the Governor
Melekeok, Republic of Palau

Subject: Final Report on the Performance Audit of Melekeok State Government for the period from October 1, 2008 through September 30, 2012.

Dear Governor Tellei:

This report presents the results of our performance audit of Melekeok State Government for the period from October 1, 2008 through September 30, 2012.

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

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

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

Sincerely,

Satrunino Tewid
Public Auditor
Republic of Palau

MELEKEOK STATE GOVERNMENT
October 1, 2008 through September 30, 2012

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Executive Summary

November 18, 2014

Honorable Aloysius Tellei
Governor, Melekeok State Government
Office of the Governor
Koror, Republic of Palau 96940

Subject: Final Report on Performance Audit of Melekeok State Government for the period from October 1, 2008 through September 30, 2012.

Dear Governor Tellei:

This report presents the results of the Office of the Public Auditor's (OPA) performance audit of Melekeok State Government for the period from October 1, 2008 through September 30, 2012.

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

As a result of our review, the Office of the Public Auditor found a number of problems and deficiencies noted below relating to the administration of Melekeok State funds, which we believe should be brought to the attention of management for appropriate corrective action. We also propose recommendations which, if implemented, we believe will correct these problems and deficiencies.

First, the Governor has not taken affirmative corrective actions to resolve audit findings contained in the Office of the Public Auditor's previous audit report covering fiscal years 2000-2005.

Second, a supplemental budget for fiscal year 2010 appropriated funds in excess of estimated revenues by \$900 and the State may have expended funds without budget authority from January 1, 2012 through January 30, 2012.

Third, the State made purchases the value of which exceeded \$5,000 without competitive bidding.

Fourth, the State spent \$2,988 on travel without supporting documents to substantiate the use of funds.

Fifth, compensation for the Governor may have exceeded the amount established by law.

Sixth, the system of accounting for and monitoring State fixed assets was inadequate.

Seventh, the State paid \$8,700.98 for legal services without any contracts or detailed billings setting forth matters for which legal professionals were engaged, the nature of services rendered, billing rates, time charges, etc. to justify the payments.

Eighth, \$1,400 was used to pay for cash prizes during the Memorial Day activities but lacked proper supporting documents.

Ninth, bank reconciliations were not properly performed and adjustments lacked adequate justification.

Tenth, the State Treasury does not consistently issue cash receipts to document revenue collections.

Eleventh, cash advances were issued to employees but there are no policies and procedures to regulate cash advances.

Twelfth, funds were disbursed to the late and current Governors that may be in violation of the Procurement Law and Regulations as well as the Code of Ethics Act.

Thirteenth, the Melekeok State Public Lands Authority may not be aggressively monitoring and enforcing its lease agreements.

Fourteenth, \$13,077 were expended in fiscal years 2009 through 2011 without proper supporting documents to justify the nature of goods and services purchased, their cost, quantities, etc.

Fifteenth, \$30,000 of lease payments was not deposited into the State Treasury but instead deposited into Melekeok Investment and Finance Authority, which may be in violation of the Republic of Palau and Melekeok State Constitutions.

Recommendations

First, we recommend that the Governor implement corrective actions to resolve audit findings contained in the Office of the Public Auditor's previous audit report, which covered fiscal years 2000-2005.

Second, we recommend that State budgets be thoroughly reviewed to ensure that funds available for appropriation is more than or equals the amount appropriated and that the Governor plans ahead on proposed continuing resolution measures to ensure adoption by the State Legislature before the end of the budget cycle to avoid a government shutdown.

Third, we recommend that the Governor establish measures to ensure that purchases involving the expenditure of State funds of \$5,000 or more are subject to competitive bidding.

Fourth, we recommend that the Governor either adopt the National Government's Executive Branch Travel Policies and Procedures or establish separate travel policies and procedures for the State.

Fifth, we recommend that the Governor follow the Melekeok State Constitution and laws in providing compensation to State Officials.

Sixth, we recommend that the Governor establish and implement a fixed asset accounting system to account for the acquisition and disposition of the State's fixed assets.

Seventh, we recommend that in engaging legal or other professional services the Governor execute contracts specifying the nature of services to be provided, billing rates, methods of billing and payments, and related terms and conditions.

Eighth, we recommend that the Governor ensure that payments made out to "cash" contain the proper supporting documents.

Ninth, we recommend that the Governor seek and obtain training for State Treasury staff on performing bank reconciliations.

Tenth, we recommend that the Governor direct the State Treasurer to issue cash receipts to document all revenue collections.

Eleventh, we recommend that the State, if it continues to provide cash advance to its employees, that it establishes policies and procedures to regulate cash advances and their repayment.

Twelfth, we recommend that Governor seek and obtain training for State officials and employees on the Republic of Palau Procurement Law and Regulations as well as the Code of Ethics Act.

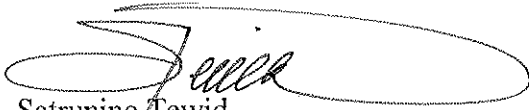
Thirteenth, we recommend that the Melekeok State Public Lands Authority as lessor of State public lands aggressively monitor and enforce the terms and conditions of its lease agreements.

Fourteenth, we recommend that the State Treasurer be more stringent in overseeing disbursements of State funds to ensure that they are validated by the proper supporting documents.

Fifteenth, we recommend that all Melekeok State funds from whatever source be deposited into State Treasury in accordance with the Republic of Palau and Melekeok State Constitutions.

Finally, the OPA would like to thank the staff and management of Melekeok State Government for the professional courtesy and cooperation extended to us during the audit.

Sincerely,



Satrunino Tewid
Public Auditor
Republic of Palau

Background

Melekeok State is one of sixteen states in the Republic of Palau. On September 1983, the Melekeok State Government was established by the State Constitution. Pursuant to the Constitution, the executive functions of the State are administered by High Chief Reklai, who is the head of state, and the Governor, who is an elected official.

The legislative functions are vested in the Melekeok State Legislature composed of 16 members. The members include the top four traditional chiefs of Ngara-Bai Melekeong, namely Reklai, Rechebong, Ruluked, Ngirkungil, six additional chiefs called Rubekul Telngal, namely Ngetibuchel, Orukei, Secharuleong, Renguul, Yobech and Ngiraingas, and five legislators and the Governor who are elected at-large for four-year terms.

No bill can become law unless passed by a majority of the members of the Melekeok State Legislature and approved by both High Chief Reklai and the Governor. The compensation of High Chief Reklai, the Governor, and the members of the Melekeok State Legislature are established by law.

The Republic of Palau and the Melekeok State Constitutions expressly require that a state treasury shall be established into which all public funds from taxes and any other sources must be deposited. In addition, no state funds may be withdrawn from the Treasury except by law.

Pursuant to the State Constitution, High Chief Reklai and the Governor must prepare an annual budget for the State and submit to the Melekeok State Legislature the budget together with a complete financial report of the receipts and expenditures as well as of the balance of public funds remaining in the State Treasury.

Objective, Scope and Methodology

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

The scope of the audit covered the period from October 1, 2008 to September 30, 2012. As this is a performance audit, we did not conduct audit procedures to assess the accuracy of the State's

financial statements or any component or account within those financial statements and therefore express no opinion on the financial statements.

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

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

To accomplish our audit objective, we reviewed accounting records including cash receipts, expenditures, accounts receivable, accounts payable, fixed assets, and payroll expenditures. In performing the review, we conducted specific tests of transactions of these components of the State's accounting system and procedures to assess the adequacy of the State's system of internal controls. The audit involved reviewing accounting records maintained by the State as well as records maintained at the Bureau of National Treasury. We also interviewed appropriate state officials.

Finding No. 1: Outstanding Prior Audit Findings and Recommendations

Melekeok State should comply with 5 PNCA § 401 by implementing the audit recommendations contained in the Office of the Public Auditor's (OPA) prior audit report covering fiscal years 2000-2005.

The late Governor responded to the prior audit report by providing corrective action plans to resolve the audit findings and recommendations, which have yet to be implemented.

It appears the cause of the above condition is lack of follow through to ensure that the corrective action plans are implemented. Hence, the findings contained in that report are still unresolved as follows:

- Unsupported payments to State Officials
- Cash receipts
- Purchases/disbursements
- Appropriation Budget
- Bank Reconciliation
- Fixed Assets
- Procurements
- Code of Ethics
- Compensation for Governor

Melekeok State's failure to take affirmative actions to implement the OPA's recommendations contained in its prior audit report constitutes non-compliance with 5 PNCA §401, which may result in the suspension of the State's block grants.

Recommendation: We recommend that the Governor implement the corrective action plans noted above in order to remedy the findings contained in the OPA's prior audit report. Doing so will strengthen internal controls over State operations and prevent possible future suspension of State's block grants.

Auditee's Response: *The increments of compensation for the Governor and High Chief Reklai in MSPL No. 5-23 was not implemented as it was amended, before it became effective, by MSPL No. 5-29 due to lack of source of fund. A copy of MSPL No. 5-23 and MSPL No. 5-29 is enclosed here.*

An Interim Fiscal Procedure provided by Melekeok State Government's former financial consultant was implemented since fiscal year 2008. This covers the procedures for cash collection, purchase/disbursement, procurement policy and documentation, bank account maintenance and

controls, payroll processing, maintenance of fixed assets, and expenditure by budget activity report. The State office have shortfalls to some extent in following these procedures which may be caused of changing of personnel, lack of proper training and poor in evaluation and monitoring. However, the state is taking up measures to meet these shortfalls. Trainings for employee are fully supported by the State office and segregation of duties is practiced. In addition, the state office will continue to modify these procedures to ensure efficiency and compliance with the state and national government regulations and policies. Attached is a copy of Melekeok State Government Interim Fiscal Procedures.

OPA's Comments: As a result of the lack of follow through to implement the corrective actions from the 2000-2005 audit, the finding were repeated in current audit.

We have reviewed the Interim Fiscal Procedures and understand that it was not fully implemented due to lack of resources and training. In addition, the Interim Fiscal Procedures has not been approved by the Governor and therefore lacks the authority for implementation. Once approved, then necessary trainings can commence and the fiscal procedures implemented.

Finding No. 2: Supplemental Budget and Continuing Resolution

Article X, Section 2 of the Melekeok State Constitution states in part: "No funds from the State of Melekeok may be expended or obligated except as prescribed by law."

Melekeok State under MSPLAW No. 7-16 appropriated the sum of \$25,682 as a supplemental budget for fiscal year 2010. Included in the appropriation law was a fund-availability analysis identifying the sources of revenue as follows: \$12,757 from 2009 Fishing Rights fees and \$12,925 from additional Block Grants per RPPL No. 8-15, for a total of \$25,682. A closer review of the appropriation law, however, reveals that the supplemental budget included expenditures adding up to \$26,582, which exceeded the source of revenue by \$900, meaning that \$900 of the 2010 supplemental appropriation had no source of revenue.

We further found that the State operated under a Continuing Resolution for the first Quarter of fiscal year 2012 (October 1, 2011-December 31, 2011) but waited until January 30, 2012 to introduce a continuing resolution (MSPLAW No. 8-01), which was approved on January 31, 2012, meaning the State lacked a budget authority to expend funds for the period from January 1, 2012 through January 30, 2012 and therefore should have been under a shutdown.

This condition is caused by the failure of those responsible for budget preparation to conduct a thorough review of the budget to ensure that the total source of revenues available for

appropriations equals the amount appropriated. In addition, the Governor failed to plan ahead his intention to introduce a Continuing Resolution budget for the period after the first quarter of fiscal year 2012.

As a result, the additional \$900 in supplemental funding in fiscal year 2010 lacked a source of revenue and the Governor may have violated the State Constitution when he expended State funds without budget authority during the period from January 1, 2012 through January 30, 2012.

Recommendation: We recommend that when preparing a State budget the Governor thoroughly review it to ensure that total revenues available for appropriation are either more than or equals the amount appropriated, as well as to verify the accuracy of other clerical and legal provisions. In addition, the Governor should plan ahead when he intends to propose continuing resolution measures. Such advance planning is essential to ensure that a continuing resolution is introduced and approved so that a continuing budget authority is in place to avoid a government shutdown.

***Auditee's Response:** Fiscal year 2012 coincides with Melekeok State election calling for the state office to operate on a continuing resolution. The 7th Melekeok State Legislature adopted on August 9, 2011 MSPLAW No. 7-19 authorizing and appropriating a continuing resolution for the First Quarter of fiscal year 2012. Please find attached is MSPLAW No. 7-19.*

Melekeok State Government aims to operate on a balanced or surplus budget. After a thorough review, we had found the discrepancy in MSPLAW No. 7-19 of \$900.00 as an erroneous mission of one budget line item in the preparation of the language of our supplemental budget. Therefore, the State office agrees with the recommendations as stated. The Office of the Governor will work closely with Melekeok State Legislature prior to the adoption of our budget bills.

OPA's Comments: Because MSPLAW No. 7-19 was not initially provided for our review, we have reviewed the document and revised the finding to reflect the language contained in MSPLAW No. 7-19. Having done so; however, it should be mentioned that MSPLAW No. 7-19 provided Continuing Resolution only for the First (1st) Quarter of Fiscal Year 2012 (October 1, 2011-December 31, 2011) and therefore the expenditures for the period of January 1, 2012-January 30, 2012 lacked budget authority for reasons explained above.

Finding No. 3: Competitive Bidding

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

During the audit we found that the State procured a boat and automobile without competitive bidding, even though the costs of each exceeded \$5,000. Details of the expenditures are shown below:

Check Date	Check No.	Amount	Vendor	Description
12/27/10	4647	\$ 7,500	Palau Investment and Development Company	Boat w/25 hp engine and a trailer
5/3/12	34	5,100	IR Automotive	2003 Mazda Demio
	Totals	\$ 12,600		

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

Because of the lack of competitive bidding, we were unable to determine if the State obtained the lowest price or best quality product for the money it spent.

Recommendation: We recommend the Governor adhere to the Republic of Palau’s Procurement Law and Regulations by ensuring that State procurements greater or equal to \$5,000 are subject to competitive bidding.

Auditee’s Response: Melekeok State Government was unaware of the bidding requirement for purchase above \$5,000.00. We thought that we are adhering to the national procurement law with the understanding to carry out a bidding process when purchasing above \$10,000.00. Purchases made by the State office above \$5,000.00 but below \$10,000.00 did not undergo bidding process because of this understanding. The Ngardok Project, which was estimated to cost above \$10,000.00 had gone through a bidding process. The Office of the Governor had advised the administrative assistant and accountant to review the procurement law and regulations of the national government. Currently, the state office is streamlining their purchasing process to conform to existing procurement laws and regulations. Attached are the bidding papers for L&R Construction.

OPA's Comments: This issue reiterates the OPA's recommendation under Finding 12 that the State seeks and obtains training for State Government officials and employees on the Republic of Palau Procurement Law and Regulations.

Finding No. 4: Travel Policies and Procedures

Official travel paid for with public funds should be regulated by policies and procedures to ensure that travel by State officials and employees is undertaken in the interest and benefit of the State and that travel funds are properly accounted for.

We found that the following checks were disbursed for official travel but were not supported with adequate travel documents such as invoices, receipts, or trip reports to verify that official business was conducted and to account for the travel funds used:

Check Date	Check No.	Amount
10/2/08	2665	\$ 198
2/20/09	3032	500
1/11/11	4675	400
1/12/12	5496	1,000
5/31/12	5804	590
9/6/12	6012	300
	Totals	\$ 2,988

The underlying cause of this condition is the absence of State travel policies and procedures to regulate and account for funds used for official travel.

As a result, \$2,988 of State funds was expended on travels without proper supporting documents to demonstrate the official nature of the business conducted and to account for the expenditure of these funds.

Recommendation: We recommend that the Governor either adopt the National Government's Executive Branch Travel Policies and Procedures or establish separate travel policies and procedures for the State that resembles those of the National Government. In either case, travel policies and procedures are essential to ensure that travel funds are used only for official purposes and properly documented and accounted for. At a minimum, the travel policies and procedures should require a traveler to file within a specified period after completion of travel a travel voucher with supporting documents such as a Travel Authorization, invoices and receipts for authorized expenses.

***Auditee's Response:** We concur with the Office of the Public Auditors recommendations as stated. In fiscal Year 2012 we started to use Travel Authorizations but not aware of travel vouchers and other documentations therefore, we still need to set up the state's own travel policies and procedures. Without such policies our travel expenditures went without complete documentations. The state office has acquired a copy of the national government executive branch travel policies and procedures and will establish our own state travel policies and procedures by end of FY 2015.*

OPA's Comments: When promulgating the State's own travel policies and procedures, careful attention should be accorded to the documentation requirements (i.e. receipts, Invoices, travel vouchers, etc.) and details to ensure the State's Travel Policies and Procedures mirror those of the National Government or a close reflection of it.

Finding No. 5: Compensation for Governor, Ngarabaimlekeong, and Employees

a. Compensation for Governor

Article VIII, Section 3, of the State Constitution states: "The compensation for High Chief Reklai and the Governor shall be established by law." In addition, Article IX, Section 7, states: "The members of the Legislature of the State of Melekeok shall be compensated as prescribed by law."

Melekeok State has enacted a State law, MS Public Law No. 5-29, establishing the salary for the members of Melekeok State Legislature at \$5,200 per annum, which is to be paid in \$200 bi-weekly installments. Section 2 of the Act sets the annual salary of the Governor and the High Chief Reklai at \$17,498 each to be paid in equal bi-weekly installments.

Our review of payroll expenditures at the Bureau of National Treasury and Melekeok State disclosed that in fiscal year 2012 the Governor was compensated in the amount \$450 for services rendered to the Ngardok Nature Reserve. (The Ngardok Nature Reserve is a designated Protected Area Network (PAN) site.) This compensation, which was paid through the State treasury, was in addition to his compensation as Governor pursuant to MS Public Law No. 5-29(2).

The Governor did not seek legal advice as to the effect of his compensation from Ngardok Nature Reserve on his statutory compensation as Governor.

As a result, the additional compensation in the amounts of \$450 paid to the Governor may have violated Melekeok State Public Law No. 5-29 and the State Constitution.

Recommendation: We recommend that the Governor follow the Melekeok State Constitution and laws in providing compensation to State officials. In addition, the Governor should seek legal advice when providing compensation to State officials for services rendered outside of or within those services for which the same officials are compensated pursuant to State law. Finally, we recommend that the Office of the Special Prosecutor or the Attorney General's Office further investigate the above compensation and take appropriate action for any misconduct involving the use of public funds.

Auditee's Response:

Compensation for State Legislators – State Legislators, by statute, is paid an annual honorarium of \$5,200.00 which is paid on a bi-weekly basis for \$200.00. The three Legislators mentioned in your audit findings are new Legislators whose seats took effect on January 10, 2012. Payroll for these three legislators are processed from the national treasury. Our explanation of this is that \$80.00 of the sums that were paid to these Legislators was an obligation carried over from the immediately preceding pay period, and was the total amount owing to each of these Legislators for that prior pay period. For reasons of convenience, no paychecks were issued for these Legislators for earlier pay period, and carried over and included the amount owing in the paycheck for later pay period. Supporting documents including the relevant time sheets for two pay periods is enclosed.

OPA's Comments: The supporting documents were not provided to us during the audit; however, after a thorough review of the additional supporting documents provided after the issuance of the Draft Report, we concur and therefore the Finding pertaining to the legislators' compensation is removed.

Compensation for Governor - We agree on your finding that the Office of the Governor did not seek prior legal advice concerning the issue of whether there were any legal problems with this dual compensation. In hindsight, we agree that it would have been prudent to seek such counsel. That being said, however, we have consulted legal counsel on this point after receiving the Draft Report, and have been advised that the Governor's employment by the Ngardok Nature Reserve presents no prima facie legal conflict or violation of any laws of Palau. The Governor got paid as an Acting Reserve Manager and not as Governor. The employment ended as soon as our Program Manager was hired. Nonetheless, we appreciated being made aware of the need to act more cautiously in this regard, and we will remain mindful of this moving forward. Attached here is the employment contract to support our response.

OPA's Comments: Because Ngardok Nature Reserve is an agency of the State, and its Board members are appointed by the Governor and High Chief Reklai, in addition to the issue of double compensation, which we were not provided a legal opinion to dispute our conclusion, it also raises an issue of potential conflict of interest for the Governor. The Ngardok Nature Reserve Act

delegates specific authorities and responsibilities to the Governor with regards to administration of the reserve, which presumably the Governor would discharge the services and be compensated pursuant to his salary as the Governor.

b. Compensation for Ngarabaimелекеong

A sound system of internal control dictates that a centralized treasury should be responsible for the disbursement of funds to ensure that transactions are adequately documented and recorded and that records are properly maintained.

During the audit we found that the following checks were disbursed to High Chief Reklai as compensation to members of Ngarabaimелекеong:

Check Date	Check No.	Amount
10/23/08	2736	\$ 840.00
12/22/08	2892	1,260.00
3/30/09	3129	1,260.00
6/4/09	3284	840.00
8/13/09	3506	840.00
9/24/09	3622	840.00
12/31/09	3905	1,260.00
	Total	\$ 7,140.00

These checks were disbursed to Reklai and then deposited to a bank account from which compensation for members of Ngarabaimелекеong were issued. We were unable to determine whether this account was personal or official. We further found that there was no adequate documentation to determine which member(s) received compensation, the amount(s) of compensation or the date(s) received. Moreover, because of the manner in which the compensation was administered, the State lacks detailed records of compensation to each individual member.

The Governor did not ensure that compensation to members of Ngarabaimелекеong was processed and disbursed through the State Treasury. In addition, the Governor and High Chief Reklai did not ensure that the members' compensation was properly documented and recorded.

As a result, the \$7,140 of compensation provided to members of Ngarabaimелекеong lacked accountability and supporting documentation to evidence that the members received the compensation.

Recommendation: We recommend that the Governor process and disburse all payments, for compensation or otherwise, through the State Treasury. The State Treasury has an inherent internal

control system for the disbursement of State funds that would ensure that transactions are properly documented and recorded.

***Auditee's Response:** The amount of \$7,140 cited in your Draft Audit Report was properly deposited to the High Chief Reklai's account solely for the purpose of compensating Ngarabaimелекеong members. We have attached deposit slips to prove their deposits to the bank account. We had seen that this process will rise suspicions and difficulties so we just decided to close the account in fiscal year 2010. Melekeok State Office wanted a transparent and responsible accounting of all our records and documents thus we agree to the OPA's recommendation.*

OPA's Comments: Based on the additional documents provided, we have revised the audit finding but still retain the issue(s) regarding compensation to members of Ngarabaimелекеong, which documentation was inadequate.

c. Personnel System for State Employees

A sound system of internal control for payroll requires that the State maintain personnel files for each employee. Such files should contain, at a minimum, an employment application, a personnel action form, employment contract, allotment forms, evaluations and documentation of disciplinary actions.

We found that the personnel records for a number of employees, to whom some \$2,601 in compensation was disbursed in fiscal years 2009 and 2010, lacked one or more of these documents. For example, some of the files disclosed an absence of Personnel Action Forms or allotment authorizations or contained contracts that did not state the employee's hourly rate or salary.

We found, however, that payrolls disbursed in fiscal years 2011 through 2012 were properly authorized and documented with the exception of allotment authorizations, which the State has not implemented.

It appears that previously the State had in place a personnel system for its employees which it failed to adequately implement. However, the Governor in office in 2011 and 2012 implemented the system to properly document personnel actions to support the State's payroll expenditures.

Recommendation: We commend the Governor for improving and strengthening the personnel system for the State; however, we recommend that the Governor adopt the use of allotment authorizations and continue to maintain and upgrade the system as necessary.

***Auditee's Response:** It is our gratitude for the Office of the Auditor's commendation. It is our goal to have a system of compliance and accountability.*

Melekeok State Office is currently using allotment authorizations in our payroll system in the State Treasury; however, we have yet to implement this to payroll processed from the national treasury.

Finding No. 6: Fixed Assets

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

We found that the State's system of monitoring and accounting for its fixed assets was inadequate. The schedule of fixed assets provided by the State covering the period from fiscal year 2009 through 2012 was incomplete. For example, a Canon camera, an air conditioner and grass trimmers were not included in the list but were discovered during expenditure testing. In addition, a copier machine that cost \$360 was recorded at \$400 with no explanation to the increase in the recorded value.

The cause of this condition is the lack of a fixed asset accounting system. Such an accounting system should require periodic inventory and inspection to determine the condition and location of the fixed assets, as well as ensuring their recording in the accounting system.

As a result, the State's fixed asset listing was incomplete.

Recommendation: We recommend that the Governor establish and implement a fixed asset accounting system to account for the acquisition and disposition of the State's fixed assets. The fixed asset accounting system should include the following:

1. Procedures to record fixed asset acquisition, which include the acquisition date, description, acquisition cost, vendor, location and condition.
2. Procedures to identify, inspect, and conduct periodic physical inventory of the fixed assets.
3. Procedures to record the disposal of fixed assets.

Finally, within a reasonable time of the issuance of this audit, the State should conduct a comprehensive inventory of fixed assets purchased in prior years, which would include a description, vendor, cost or best estimate of cost, location and condition of the assets. Assets that are no longer operational or have been disposed of should be removed from the fixed asset listing.

***Auditee's Response:** Melekeok State will comply with the recommendation. The Interim Fiscal Procedures includes the accounting of fixed assets however the State complied only in a certain degree resulting to inadequate data regarding our fixed assets. We will be conducting a comprehensive inventory and revise the recording of our assets so we can get an accurate report on fiscal year 2015.*

OPA's Comments: It is recommended that the Interim Fiscal Procedures be approved by the Governor so that it becomes an authoritative policy that compels implementation.

Finding No. 7: Legal Service Fees

A sound system of internal control requires that when purchasing professional services the State should enter into formal written agreements. These contracts should specify the nature of services to be rendered, billing rates, methods of billing and payment and other terms and conditions that promote the needs of the State and protect its interests.

The audit revealed that the State paid for legal services to several attorneys one of which the representation agreement between the state and the attorney was not signed. In addition, some of the billings and invoices did not specify in detail the nature of services rendered to enable us to determine if the services were for the benefit or interest of the State, especially for billings accrued from the prior administration. Provided below is a schedule of payments for legal services:

Check Date	Check No.	Amount
10/2/08	2666	\$ 700.98
3/26/09	3120	1,000.00
4/9/09	3152	1,000.00
12/17/09	3868	1,000.00
2/16/10	4029	5,000.00
	Total	\$ 8,700.98

The absence of necessary signatures on the representation agreement suggests that the Governor did not ensure that the agreement was properly signed by both the state and the attorney. In addition, the lack of details concerning the nature of services rendered makes it difficult to determine how the services benefit or serve the interest of the State.

Without the necessary signatures on the representation agreement to validate the document, we were unable to determine if the services provided; method of billings and payments were properly agreed to by the parties.

Recommendation: We recommend that the Governor obtain necessary signatures when executing contractual agreements for legal or other professional services in order to validate the agreement and to promote the needs of the State and protect its interests. In addition, the Governor should require its attorney when billing the State to provide details specifying the exact nature of services rendered and a time log showing time spent on each activity.

Auditee's Response: Most of the legal service fee payments subject to your audit findings are fees incurred by the last administration which became the State office obligation and has to pay. Such records are hard to locate and if we have them they are incomplete. This is one area the Office of the Governor wants to correct, the system of filing records.

Currently, we are vigilant in filing our documents. Please find attached are the records of legal services the State Office has paid from FY 2010 to FY 2012 which include contractual agreements and billings of services. These records ensure that the Office of the Governor had appropriately purchase legal services for the benefit of the State. We assure your office that your recommendation is already being implemented.

OPA's Comments: Based on the additional documents provided, the finding has been revised to reduce the questionable payments without supporting documents. In the future, the State should maintain files for each professional service that it engages. Each file should contain a contractual agreement, invoices or billings for services rendered, and such other essential documents. The files should be securely filed and retained so that they are available for review and to validate claims against the State for outstanding billings.

Finding No. 8: Memorial Day Donations, Prizes, and Other Cash Disbursements

Cash prizes for State memorial events and other special occasions should be properly documented to support the expenditures and to demonstrate to donors that their donations were used for their intended purposes.

The audit revealed that the State solicited and received the sum of \$1,400 in monetary donations towards prizes for the annual State Memorial Day event in November 2010. We found that the donations were deposited into the State Treasury and a check was disbursed to the Governor for the same amount and was cashed. The State issued checks to various hamlets as prizes for a beautification contest but awarded \$1,400 as cash prizes for various games and activities. These cash awards lacked proper documentation to show who received the prizes, the amount of each prize, and the total of prizes awarded. Such documentation is critical to properly account for the prizes awarded in cash.

The following checks were issued to Hamlet Chiefs as prizes for the Beautification contest:

Payee	Check Date	Check No.	Amount
Oketol Elbelau Ngerubsang Hamlet	11/26/10	4583	\$ 200.00
Yobech Robert Isimang Ngerang Hamlet	11/26/10	4582	200.00
Secharruleong Theodore Rengulbai Ngermelech Hamlet	11/26/10	4579	200.00
Orukei Miawo Kadoi Ngeruliang Hamlet	11/26/10	4578	200.00
Ngetibuchel Alfonso Megreos Ngeburch Hamlet	11/26/10	4577	200.00
Renguul Peter Elechuus Ukaeb Hamlet	11/26/10	4581	175.00
Total			\$ 1,175.00

The Governor did not ensure that proper records were kept to support and account for the disbursements in cash for prizes.

As a result, we were unable to determine the propriety of the awarding of \$1,400 in cash prizes.

In a similar but distinct instance, we found that check number 4529, dated November 3, 2010, in the amount of \$5,000, was issued to the Governor for a coconut planting project. The funds were intended to provide compensation for the workers. The compensations were paid out in cash instead of by check. These expenditures, in contrast to the Memorial Day prizes, were supported by proper documentation.

Recommendation: We recommend that the Governor establish a process to document and account for disbursements made in cash to strengthen controls and accountability. All disbursements done by cash for whatever purposes should be properly documented as is done for transactions made by check. Supporting documents are essential to justify expenditures, to enable proper recording in the accounting system, and to demonstrate to donors that their donations were used for their intended purposes. In addition, we recommend that, when practical, the Governor should process all compensations by check, not cash, to strengthen controls over disbursements.

Auditee's Response: *Every year Melekeok State holds a competition of the cleanest cemetery in line with our Melekeok Memorial Day. An inspection team is created to decide which hamlet is the cleanest. This inspection is done three or two days before the Memorial Day hence the State office was able to fix the prizes in checks for this event. Please see attached is the inspection report where the prizes were based.*

The Melekeok Memorial Day is a state holiday and is celebrated after Thanksgiving Day with program and games. An award night ceremony was held to close the celebration. We paid cash as prizes in our Memorial Day activities as a response to people's request that they may get their prizes in the amount due them so they can enjoy it instantly. The cash was awarded to individuals or group of individuals who participated in the games and programs. Our hands were full of the events that we failed to ensure proper documentation of the cash handed to the organizing committee.

The State office was committed to the enjoyment of its constituents only that we failed to ensure accountability of the cash prizes. We will heed Office of Public Auditor's (OPA) recommendations to avoid the same finding in future events and programs.

OPA's Comments: In the future we suggest that the Governor have "The Committee" prepare forms for cash prizes so that when cash prizes are awarded, recipient(s) print and sign their name (s), and date acknowledging receipt of cash prizes.

Finding No. 9: Bank Reconciliation

Monthly bank reconciliation is an essential internal control of any cash management system. It enables the organization to detect errors or irregularities in cash receipts (deposits) and disbursements that, if not timely detected, can cause cash balance per book to go out of balance with the bank and, to some degree, result in unnecessary charges such as insufficient fund (NSF) and service charges.

During the audit we found numerous adjustments to bank reconciliations for which there were no explanations or justifications. For example, we noted adjustments for checks that had cleared the bank and subsequently recorded as debit memos to the bank reconciliation. Check amounts also were added back to the bank balance as credit memos but there was no evidence to justify restoring the amounts. In addition, the ending balance for April 2012 in the amount of \$19,009.56 was supposed to be used as a beginning balance for the May 2012 reconciliation but \$10,478.15 was used instead.

It appears that bank reconciliations were not properly performed and adjustments lacked adequate justification.

As a result, management relied on bank reconciliations and cash balances that may not have been accurate.

Recommendation: We recommend that the Governor obtain training for Finance Office staff in performing bank reconciliation. In addition, after the staff has obtained training, the responsibilities for bank reconciliation should be segregated so that one staff performs bank reconciliation and a senior staff reviews for accuracy.

Auditee's Response: As compliance to the prior year audit recommendation and as well to guarantee cash availability and to settle difference between bank and book balances, the state office is performing monthly bank reconciliation. The state office is utilizing Accounting software in recording its transactions. Those transactions that were already reconciled and were erroneously un-cleared in the accounting register will show a different beginning balance from the previous bank statement. Our finance staff lacks the proper training of using this software therefore; manual bank reconciliation is prepared to back up reconciliations done using the accounting software. We used an easy format for management to easily understand. In our reconciliations, checks that were added back as a credit memo to the cash per book were checks issued but never cleared the bank which apparently became stale checks. Checks that actually cleared the bank but are not recorded in our books were recorded as debit memo to the cash per book. The adjusted bank and book cash balance must be equal.

The state office supports training for our employees. Our finance staff has attended several trainings the past couple of years and will continuously go to trainings to give a more accurate reporting and information in the future.

OPA's Comments: Stale-dated checks should be voided, the book balance restored and any replacement check should be properly identified as such. On the other hand, checks that have cleared the bank, but not recorded in the books, should be recorded and the book balance adjusted accordingly.

Finding No. 10: Cash Receipts

A sound system of internal control requires issuance of cash receipts to account for and evidence revenue collections and to support their deposit and classification by source.

We noted that Melekeok State does not consistently issue cash receipts to document revenue collections or have basic policies and procedures governing cash receipts. Collections were not consistently deposited in a timely manner; some cash receipts were post-dated after deposit and others were held for over ten (10) days before deposit. Moreover, there was no accounting in place to match receipts to corresponding deposits, a critical missing control considering that deposits were not made in a timely fashion.

In one instance, the State purchased an item for \$79.95 on May 15, 2012, returned it on May 21, 2012 and received a cash refund; the refund, however, was not deposited until October 22, 2012, some five months later.

As a result of the absence of policies and procedures for issuing cash receipts, the State has very weak controls over revenue collections. Moreover the untimely deposit of collections coupled with the inability to match cash receipts to deposits exposes collections to potential malfeasance. The lack of cash receipts also invites disputes as to the accuracy of revenue classification in accounting records due to absence of source documents.

Recommendation: We recommend that the Governor promulgate basic policies and procedures governing cash receipts. At a minimum, cash receipts should be issued to support all revenue collections. In addition, a form should be created to support deposits made. The form should identify sources of revenues such as block grants, fishing rights fees, or local revenues, identify the cash receipts supporting the collections to be deposited, and identify checks, denominations of cash, and coins being deposited. In addition, the collections should be reviewed and verified by another employee before deposit.

Auditee's Response: At present, Melekeok State Government is issuing cash receipts in all of its revenue collections. Segregation of duties is in place to ensure internal control in our collections and deposits. Separate individuals are collecting and issuing receipts, recording the collections, and depositing. We are currently using a transmittal form submitted by our collector for the recording of such. Collections are then recorded into our cash receipts journal where their sources are identified. The transmittal form and a copy of deposit slip are attached together in our filing to guarantee they match. Please see attached are the forms we are using for your review.

The State Office is located in Melekeok State which is miles away from the business center where our banks are located. It is not practical for the State to make deposits of small amounts every day. In average the State collects less than 50.00 daily hence we held are collections in our safe vault and assigned a schedule of deposits and other work errands. In addition, the \$79.95 cited in your findings is a cash refund assigned to receipt no. 2371 which was included in the deposit into our General Fund in May 31, 2014. This amount was originally disbursed from our Special Revenue account – PAN Fund and after we close our books at the end of fiscal year 2012 we corrected this error by depositing it into the PAN fund account. Attached is the check we issued for this deposit. Furthermore, in fiscal year 2014 we started to utilize the accounting software in entering our receipts so it will be easy to identify the breakdown of deposits and classify sources of our revenues.

As previously mentioned cash collection is included in our Interim Fiscal Procedures and we will continuously modify this to ensure compliance to existing rules and regulations and tighten our internal controls.

OPA’s Comments: The term “timely deposit” should not be construed as “daily” deposit but as within reasonable time. Of course, the amount of daily collections and remoteness of the State from the bank are factors that need to be considered in making policy decisions. The transmittal form to support deposits is a good start to improve controls over cash receipts and deposits and can be revised as circumstances and conditions arise that would necessitate revision. Again, we recommend that the Interim Fiscal Procedures be approved by the Governor to give the document the proper authority for implementation.

Finding No. 11: Cash Advances

Policies and procedures should be established to control and regulate cash advances to employees.

During the audit, we found that the following checks were issued to the late Governor and state employees as cash advances:

Check Date	Check No.	Amount
5/8/09	3222	\$ 800.00
8/6/09	3476	300.00
8/26/09	3517	1,600.00
	Total	\$ 2,700.00

The two employees who received the \$800 and \$300 cash advances repaid the State in full through payroll allotment; however, the late Governor only paid back \$546.55.

Receipt No.	Amount Paid	Cash Advance	Remaining Balance
1023	\$ 546.55	\$ 1,600.00	\$ 1,053.45

Therefore, based on the information received, we consider the \$800 and \$300 cash advances resolved; however, the late Governor still carries a balance of \$1,053.45 outstanding.

The likely cause of this condition is the absence of policies and procedures to regulate cash advances to employees.

As a result, the late Governor failed to pay back the balance of \$1,053.45 cash advance, which the State apparently made no effort to collect.

Recommendation: We recommend that, if the State continues to provide cash advances to its employees, it establish policies and procedures to regulate cash advances and their repayment. In addition, a recordkeeping system should be established to keep track of each cash advance and repayment to ensure timely and full repayment. Finally, the Governor should pursue the collection of the balance of cash advance that has not been paid back in full.

***Auditee's Response:** In your audit finding check no. 3476 in the amount of \$300.00 was paid in full. Please see attached are the copy of payroll checks where cash advance payments were deducted. Our records show that the late Governor made a partial payment of \$546.55 recorded in Receipt No. 1023. We will seek advice on how to recover the remaining balance of \$1,053.45 from the late Governor.*

The State Office recognizes and is dedicated to help in the emergency needs of our employees thus we would like to continue providing them cash advances. We will create a strong policy to regulate our employee cash advances and their repayments to ensure transparency and accountability. Cash advance policies and procedures will be in place by end of January 2015.

OPA's Comments: Based on the additional documents provided, we concurred and therefore the finding has been revised accordingly. If the State sees a need to continue providing cash advances to its employees then it is imperative that the State establish the requisite policies and procedures to control and monitor the process. Equally important is an accounting system to record the advances and the repayment of the cash advances.

Finding No. 12: Conflicts of Interest

The Procurement Law, 40 PNCA § 654 (a), states: "It is a breach of ethical standards for any employee of a government agency to participate directly or indirectly in procurement with that government agency if:

1. The employee or any member of the employee's immediate family or a dependent of the employee has financial interest pertaining to the procurement; or
2. A business or organization in which the employee, or any member of the employee's immediate family or dependent has a financial interest pertaining to the procurement; or
3. Any other person, business or organization with whom the employee or any member of the employee's immediate family is negotiating or has an arrangement concerning prospective employment is involved in the procurement."

In addition, Section 6 (d) of the Code of Ethics Act (33 PNCA § 604(d)) states in part: “No employee may use or attempt to use the employee’s official position to secure or grant privileges, exemptions, advantages, or treatment, for himself or others”

We found that check number 3594, dated September 18, 2009, and in the amount of \$540, was issued to the late Governor for the purchase of a two hundred seventy (270) pound pig that was used for the ground-breaking ceremony of the road project to the marina in Ngerubesang hamlet, Melekeok State.

In addition, check number 6049, dated September 25, 2012 and in the amount of \$1,250, was issued to the current Governor, who also served as Chairman of Ngaramecherocher Men’s Organization, for the restoration of Olsuchel Tet.

It appears that the Governors were not familiar with the prohibitions contained in the Procurement Law and Regulations and the Code of Ethics Act and, as a result, may have violated the Procurement Law and the Code of Ethics Act.

Recommendation: We recommend that Melekeok State employees, including State officials (Executive and Legislative), seek and receive appropriate training on the Republic of Palau Procurement Law and Regulations as well as the Code of Ethics Act. Furthermore, we recommend that the Office of the Special Prosecutor or the Office of the Attorney General investigate the transactions described above and take appropriate legal action if warranted.

Auditee’s Response: The grantor and the Ngarabaimelekeong had agreed, for that restoration of Olsuchel Tet must be done in the traditional manner and by a group of Melekeok men (Ngaramecherocher) to preserve its historical value. Little we know of the conflict issuing the payment for this service to the Governor who is also the Chairman of the Ngaramecherocher Men’s Organization.

Lack of knowledge of these guidelines hinders the state to perform full compliance with the law therefore we will coordinate with proper agency which can give the state officials and employees a workshop on the Code of Ethics. In addition, the office of the Governor is currently reviewing the national government Procurement Law to guide us in future procurement/disbursements.

OPA’s Comments: If Ngaramecherocher provided the services then the check should have been issued to the organization, instead of the chairman who happens to be the Governor of Melekeok State, thereby avoiding the conflict of interest.

Finding No. 13: Land Leases

Land lease agreements should be enforced by the Melekeok State Public Lands Authority (MSPLA), the Office of the Governor, and the Melekeok Investment and Finance Authority (MIFA) to ensure that the lessee adheres to the terms and conditions of the lease agreement in order to protect the rights and interests of the State.

Reklai Holdings, Ltd

On January 23, 2007, the MSPLA and Reklai Holdings, Ltd. entered into a lease agreement under which the MSPLA leased 93,822 square meters of state public lands for a period of twenty five (25) years. (The leased land is known locally as Ochab Er Ochaeco at Ngeburch Hamlet, Melekeok State). In addition, MSPLA leased to Reklai Holdings an area consisting of 6,000 square meters located at Ngerubasang Dock, Ngerubasang Hamlet.

The agreement required Reklai Holdings to pay \$500 per month to the MSPLA from February 1, 2007 through July 31, 2007. From August 1, 2007 through January 1, 2032, the lease payments were to be \$1,500 per month. The lease also required Reklai Holdings to pay royalty fees based on the commercial activities of the quarry located on the property. Specifically, Reklai Holdings was to make royalty payments (1) equal to \$2.00 per cubic yard of aggregate extracted from the quarry property and sold or manufactured into concrete plus (2) two percent (2%) of gross receipts from the sale of concrete manufactured and sold from the quarry. Reklai Holdings was required to calculate the royalty fees for each quarter and make the payments on or before the 31st day of the next month.

Because of inadequate records, we were unable to determine if royalty fees for the fourth (4th) quarter of 2009, second (2nd) quarter of 2010, fourth (4th) quarter of 2010, third (3rd) quarter of 2011, and fourth (4th) quarter of 2012 were paid. In addition, it appears that from January 2010 through September 2012 Reklai Holdings may have paid the State \$1,000 per month rather than the \$1,500 rent specified by the lease, or a total of \$17,500 less than the lease required during that period. Moreover, Reklai Holdings may not have paid the 2% levy on gross receipts on sales to the State as required under the lease agreement.

It appears that the MSPLA failed to adequately monitor and enforce compliance with this lease agreement by Reklai Holdings. In addition, the MSPLA does not maintain a recordkeeping system to facilitate an effective and efficient enforcement of the State land lease program.

As a result, Reklai Holdings may have underpaid the MSPLA a total of \$17,500 for lease rental for the period from January 2010 through September 2012 under the lease agreement. Reklai Holdings

may also have failed to pay royalty fees for five quarters and the 2% levy on gross receipts on sales entirely.

Western Caroline Trading Company (WCTC)

On December 14, 2007, the Melekeok State Government and the MSPLA entered into a lease agreement with the Western Caroline Trading Company (WCTC) for property designated as lot no. 07C001-002, which consists of 3,631 square meters. WCTC agreed to pay \$1 per square meter, *i.e.* \$3,631 per year, for fifty (50) years. In addition, Melekeok State and WCTC executed a Memorandum of Understanding by which WCTC agreed to donate money for educational scholarships at its discretion.

We found that WCTC made the lease payments from fiscal years 2009 through 2012 in accordance with the lease agreement, but made no donation to the educational scholarship program. However, as noted above, such donations are discretionary under the terms of the lease.

Palau Fish Trading, Inc.

On November 22, 2010, Melekeok State agreed to lease the Melekeok Marina in Ngerubesang Hamlet to Palau Fish Trading, Inc. for fifty years from the date the lease was signed to November 22, 2060. The lease encompassed an area of 28,628 square meters (designated Lot No. 41095) along with the buildings and other improvements in the property. The State also granted Palau Fish Trading water use rights in the waters adjacent to the Marina as well the right to use the existing port.

Palau Fish Trading, Inc. agreed to pay Melekeok State a total rental of \$1,200,000. The payments were to be made in installments. One month after the signing of the lease agreement Palau Fish Trading was to make a one-year advance payment of \$24,000. Thereafter, beginning on November 23, 2011, Palau Fish Trading would make monthly payments of \$2,000 up to the end of the lease term.

We found that Palau Fish Trading, Inc. made the one-year \$24,000 advance rental payment on December 24, 2010 and has made the required monthly rental payment of \$2,000 up to September 2012.

NetForce International Incorporated

On July 28, 2011, the MSPLA, the Melekeok Investment and Finance Authority (MIFA) and the Melekeok State Government entered into a 50-year agreement with NetForce International

Incorporated to lease 1,000,000 square meters of public lands with two options of 25 years and 24 years respectively to renew. The stated purpose of the lease was the construction of a championship-level golf complex.

NetForce International Incorporated agreed to make advance payments totaling \$150,000 -- \$30,000 as an initial payment upon the signing of the lease, and \$120,000 at the start of the construction or eighteen months from the signing of the lease, whichever came first. NetForce International was to begin rent payments of \$150,000 per year beginning with the sixth year of the lease term. If NetForce International failed to pay the rent on time, it would incur interest at a rate of 0.05% per day plus a 5% late payment penalty. Late payment could also result in forfeiture of the lease. If NetForce International defaulted on rent payments or failed to comply with any term of the lease, MIFA could declare the lease forfeited thirty days after it had given NetForce International notice.

The lease required NetForce International to complete the golf complex project within five years; if it failed to do so the property would revert to the MSPLA along with any improvements that had been made.

At the time the lease was signed there was a baseball field on the property. The MSPLA, MIFA, and the State agreed to allow NetForce International to remove this field. However, as compensation to the community for this loss, NetForce International agreed to first construct a baseball field with night lights and a track and field facility on land that the MSPLA and MIFA would designate.

The audit revealed that NetForce International made the required initial \$30,000 payment to MIFA when the lease was signed. However, contrary to the State Constitution, the money was paid directly to MIFA instead of Melekeok State Treasury, as further discussed under Finding 15 below. According to the Governor, NetForce International decided to withdraw the project. There is no evidence in file, however, to substantiate the withdrawal or termination of the lease agreement by the parties.

MSPLA, MIFA, and Melekeok State appear to have failed to monitor and enforce NetForce International's compliance with the lease agreement, especially the provisions requiring rental payment.

As a result, the State failed to collect at least \$120,000 that NetForce International should have paid. There is no evidence on file to demonstrate that the lease agreement was terminated before the \$120,000 payment was due.

Recommendation: We recommend that, in order to ensure that the rights and interests of Melekeok State are protected, the Chairman of the MSPLA closely monitor and enforce the terms and conditions of lease agreements it enters into to lease State Public Lands. In addition, the State and its agencies, such as MIFA, that co-sign lease agreements should diligently protect the interests and rights of the State in the lease agreements to ensure they are fulfilled and protected.

We further recommend that the MSPLA take timely legal action against Reklai Holdings and NetForce International to recover money owed under the terms of the relevant lease agreements. Lastly, the MSPLA should maintain a robust recordkeeping system to support effective and efficient monitoring and enforcement of lease agreements.

Auditee's Response:

Reklai Holdings, Ltd. – Melekeok State Government had received all Royalty Premiums and lease payments in question from the lease agreement with Reklai Holdings, Ltd through Hawaiian Rock Corp. Please see table below. The State Office is open for OPA to verify this information from our records.

<i>Date</i>	<i>Official Receipt No.</i>	<i>Amount</i>	<i>Quarters Paid</i>
<i>5/6/2008</i>	<i>438</i>	<i>316.00</i>	<i>4th q '07</i>
<i>6/12/2008</i>	<i>441</i>	<i>482.00</i>	<i>1st q '08</i>
<i>8/14/2008</i>	<i>463</i>	<i>506.00</i>	<i>2nd q '08</i>
<i>11/13/2008</i>	<i>561</i>	<i>1843.50</i>	<i>3rd q '08</i>
<i>3/25/2009</i>	<i>766</i>	<i>794.00</i>	<i>4th q '08</i>
<i>5/27/2009</i>	<i>853</i>	<i>1172.50</i>	<i>1st q '09</i>
<i>9/10/2009</i>	<i>952</i>	<i>1179.00</i>	<i>2nd q '09</i>
<i>12/21/2009</i>	<i>1039</i>	<i>760.00</i>	<i>3rd q '09</i>
<i>4/23/2010</i>	<i>1170</i>	<i>651.00</i>	<i>4th q '09</i>
<i>5/21/2010</i>	<i>1197</i>	<i>285.00</i>	<i>1st q '10</i>
<i>8/13/2010</i>	<i>1291</i>	<i>227.00</i>	<i>2nd q '10</i>
<i>10/22/2010</i>	<i>1432</i>	<i>685.00</i>	<i>3rd q '10</i>
<i>2/28/2011</i>	<i>1637</i>	<i>478.00</i>	<i>4th q '10</i>
<i>5/20/2011</i>	<i>1752</i>	<i>468.60</i>	<i>1st q '11</i>
<i>8/12/2011</i>	<i>1897</i>	<i>477.00</i>	<i>2nd q '11</i>
<i>11/23/2011</i>	<i>2094</i>	<i>1134.00</i>	<i>3rd q '11</i>
<i>3/5/2012</i>	<i>2216</i>	<i>301.00</i>	<i>4th q '11</i>
<i>5/17/2012</i>	<i>2355</i>	<i>331.00</i>	<i>1st q '12</i>
<i>8/15/2012</i>	<i>2624</i>	<i>248.50</i>	<i>2nd q '12</i>
<i>11/14/2012</i>	<i>2939</i>	<i>1114.00</i>	<i>3rd q '12</i>

Lease Payments

<i>Date</i>	<i>Official Receipt No.</i>	<i>Amount</i>
2/7/2007	241	\$500.00
3/2/2007	252	\$500.00
3/31/2007	262	\$500.00
4/1/2007		
5/8/2007	276	\$500.00
6/12/2007	279	\$500.00
7/2/2007	305	\$500.00
8/10/2007	311	\$1,500.00
9/12/2007	317	\$1,500.00
10/10/2007	330	\$1,500.00
11/9/2007	344	\$1,500.00
12/1/2007		
1/4/2008	374	\$1,500.00
1/18/2008	380	\$1,500.00
2/26/2008	405	\$1,500.00
3/26/2008	419	\$1,500.00
4/1/2008	511	\$1,500.00
5/6/2008	437	\$1,500.00
6/12/2008	440	\$1,500.00
8/11/2008	461	\$1,500.00
8/12/2008	462	\$1,500.00
9/5/2008	475	\$1,500.00
10/14/2008	510	\$1,500.00
11/13/2008	562	\$1,500.00
12/10/2008	604	\$1,500.00
1/15/2009	655	\$1,500.00
2/17/2009	725	\$1,500.00
3/17/2009	755	\$1,500.00
4/13/2009	805	\$1,500.00
5/27/2009	854	\$1,500.00
6/8/2009	874	\$1,500.00
7/13/2009	898	\$1,500.00
8/1/2009		
9/10/2009	953	\$1,500.00
9/30/2009	987	\$1,500.00
10/23/2009	998	\$1,500.00
11/1/2009		
12/4/2009	1028	\$1,500.00
12/31/2009	1043	\$1,500.00
1/1/2010		
2/16/2010	1099	\$5,000.00
6/3/2010	1207	\$1,000.00
7/16/2010	1259	\$1,000.00
/13/2010	1292	\$1,000.00
9/10/2010	1323	\$1,000.00
10/22/2010	1429	\$1,000.00
11/19/2010	1497	\$1,000.00
12/16/2010	1519	\$1,000.00
1/27/2011	1587	\$1,000.00
2/24/2011	1635	\$1,000.00
3/24/2011	1676	\$1,000.00
4/20/2011	1710	\$1,000.00
5/1/2011		

6/1/2011		
7/15/2011	1845	\$2,000.00
8/12/2011	1896	\$1,000.00
8/28/2011	1920	\$1,000.00
9/22/2011	1970	\$1,000.00
10/1/2011		
11/2/2011	2051	\$1,000.00
11/23/2011	2093	\$1,000.00
12/1/2011		
1/13/2012	2141	\$1,000.00
2/1/2012		
3/5/2012	2215	\$1,000.00
3/5/2012	2217	\$1,000.00
3/23/2012	2250	\$1,000.00
4/20/2012	2287	\$1,000.00
5/17/2012	2354	\$1,000.00
6/30/2012		
7/30/2012	2571	\$1,000.00
8/15/2013	2625	\$1,000.00
8/31/2012	2685	\$1,000.00
9/21/2012	2763	\$1,000.00

The lease payment was reduced to \$1,000.00 from \$1,500.00 when the company surrenders the area of 6,000 square meters and the warehouse located at Ngerubsang Hamlet, Melekeok State in FY 2010. This area is Parcel 2 in the lease agreement. Please find attach correspondence regarding the relinquishment. In addition, the company did not sell the rocks quarried from Melekeok resulting to no payment of the 2% levy on gross receipt on sales as required by the lease agreement.

OPA's Comments: In our review of relevant cash receipts, we found that some of the receipts did not indicate the quarter-ended for which the royalty fees payments by Reklai Holdings applied. And to add to the confusion, the Land Lease Agreement stipulates that the Royalty fees should be paid on or before the 31st day of the month immediately following each quarter ended April, July, October, and January. And because the State did not enforce the due date of royalty fees, and the receipts did indicate the quarter-ended that the payment applied to, it is nearly impossible to match the receipts to the corresponding quarter. In addition, the contract file did not contain any documentation, contract amendment or otherwise, to support that the lease rental payment was reduced from \$1,500 to \$1,000 per month. Moreover, the contract file was also lacking any documentation to indicate that the company (Reklai Holdings) had no sales activity that would require reporting and payment of the 2% on gross receipts.

Western Caroline Trading Company (WCTC) – The educational scholarship in the Memorandum of Understanding entered into between Melekeok State and WCTC is only waiting for an interested individual who would like to grab the opportunity. As of now, despite of our announcement nobody had stepped forward to avail the scholarship.

OPA’s Comments: The educational scholarship is discretionary upon the lessee (WCTC) so we have no issue with that.

Netforce International Incorporated – The MSPLA Chairman and my office have discussed the status of Netforce International Incorporated and learned that they, together with MIFA Chairman, are trying to get hold of the investor. Unfortunately, the investor is hard to contract and is not in Palau at present. We will compel Melekeok State Public Lands Authority and Melekeok Investment and Finance Authority to seek payment of the remaining rent balance.

OPA’s Comments: The lease rental payment for Netforce International, the \$120,000 in particular, was due eighteen (18) months from the signing of the lease agreement (lease signed on July 28, 2011), which therefore should have been due and owing on the second anniversary of the lease agreement, July 28, 2013 or earlier. Hence, the discussions regarding the arrears should have been brought up back then, not now with no agents in Palau, and the State may have to incur additional costs in its attempts to collect the outstanding rent.

Finding No. 14: Expenditures without Supporting Documents

A sound system of internal control dictates that expenditure of funds should be supported by documents that disclose the purpose of the expenditure and the cost and quantities of goods and services purchased. Sound financial management also requires source documents to support the recording of transactions in the accounting system.

Our audit revealed that the State expended \$13,077 without proper supporting documents that demonstrated the official purposes of the expenditures, disclosed the costs and quantities of good and services purchased, and support the recording of expenditures in the accounting system. The expenditures were incurred in fiscal years shown below:

Fiscal Year	Amount
2009	\$ 10,893
2010	1,160
2011	1,024
Total	\$ 13,077

This condition is caused by the State’s failure to process disbursements with invoices or other supporting documents.

As a result, we were unable to determine the propriety of the above expenditures and their classification in the state’s accounting records. Thus these expenditures constitute questioned costs.

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

Auditee’s Response: In your audit finding, check nos. 6043 and 6044 issued in FY 2012 was paid to Jerome Megreos and Herman Blaluk, respectively as judgment payments. Please see receipt and copy of judgment. And also in FY 2011 check no. 4467 was a check paid to the OBF participants and helpers as stipend. The check was made out to only one individual who partake the tasked to distribute the stipend to the others. A signature sheet was attached as proof that all the participants have received their stipend. And check no. 5075 was issued to pay for the uniforms of baseball players for Belau Games. The transaction was made by a member of the Belau games committee and we were careless to secure the receipt.

Most of the expenditures in your audit findings are transacted from the previous administration which left us with incomplete records. It is hard to locate documentations to such expenditures especially when there was a change of all of the personnel. Altogether, the State Office concurs with the OPA’s recommendation. At present, all disbursements are double checks for completeness in documentation before they are placed in our filing storage. We will continue to improve our recording and filing system to avoid the same citation in the future.

OPA’s Comments: Based on additional documents provided, the finding has been revised to reduce the amount of undocumented expenditures. Even so, the majority of the expenditures are still unresolved due to lack of supporting documentation. For check No. 4467, although a signature sheet was provided, it does not state the amount each participant received as a stipend and therefore is incomplete. To avoid similar situations in the future, the State should design forms to accommodate these unusual situations to ensure the completeness of supporting documents.

Finding No. 15: Deposit of Funds into Melekeok State Treasury

The Constitutions of both the Republic of Palau Constitution and Melekeok State require that a State Treasury be established into which all State funds are to be deposited. Both Constitutions further require that no funds shall be withdrawn from the Treasury except by law.

The audit revealed that Melekeok State Public Lands Authority leased public lands to a private investor; the initial rental payment in the amount of \$30,000 was paid directly to Melekeok Investment and Finance Authority (MIFA), and deposited to MIFA's bank account.

This condition may be caused by a lack of understanding on the part of the State and its agencies with the concept of centralized treasury requirements of Melekeok State and Republic of Palau Constitutions.

As a result, the deposit of the \$30,000 directly into the MIFA account, without being first deposited into the State Treasury and appropriated by the State Legislature, may have violated both the Republic of Palau Constitution and the Melekeok State Constitution.

Recommendation: We recommend that all Melekeok State funds from whatever source be deposited into the State Treasury in accordance with the Republic of Palau and Melekeok State Constitutions. In addition, upon deposit of funds into the State Treasury, the funds should be appropriated by the Melekeok State Legislature prior to their withdrawals. Moreover, because of the method by which lease rental fees were paid directly to MIFA, we recommend that the Governor, Chairman of the MSPLA, and Chairman of the MIFA collaborate to rectify the violation in the deposit of the funds.

Auditee's Response: We agree to the recommendations as stated. In fact, the Melekeok State Legislature had created and adopted in May 2014 MSPL No. 8-12, specifically Section 12, which commanded MIFA that all revenues from its undertakings be deposited to the Melekeok State Treasury and Section 18 (b) that all funds in the name of MIFA shall be released and deposited to the Melekeok State Treasury.

OPA's Comments: According to the version of MSPL No. 8-12 that was provided to us, the document was not signed by the Governor and therefore we are unable to determine the validity and effect of the legislation given the provisions of the State Constitution under Article VIII, Section 4, which states in part: "Legislation drafted and approved by the Legislature of the State of Melekeok to become law shall be signed by High Chief Reklai and the Governor."



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

**OFFICE OF THE PUBLIC AUDITOR
REPUBLIC OF PALAU
P. O. BOX 850
KOROR, REPUBLIC OF PALAU 96940**

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E-MAIL ADDRESS: admin@palauopa.org**

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

(Closed on Legal Holidays)