

Gagil Tomil Water Authority

**Financial Statements and
Independent Auditor's Report**

**Fiscal Year Ended
September 30, 2005**



**Office of the Public Auditor
State of Yap
Federated States of Micronesia**



OFFICE OF THE PUBLIC AUDITOR

STATE OF YAP

FEDERATED STATES OF MICRONESIA

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EXECUTIVE SUMMARY

Financial Audit of the Gagil-Tomil Water Authority for the Year ended September 30, 2005

The Office of the Yap State Public Auditor has completed the audit of the Gagil-Tomil Water Authority (GTWA) for the year ended September 30, 2005 for which report is dated April 25, 2006. The Independent Auditor's Report on page 1 is a disclaimer. Due to the lack of reliable accounting records for fiscal year 2005, we were not able to form an opinion on the fairness of the financial statement amounts. Accordingly, we express no opinion on the financial statements of the GTWA as of and for the year ended September 30, 2005.

The report on internal control and compliance and other matters required by *Government Auditing Standards* on page 11 discusses reportable conditions at GTWA. These conditions and our recommendations are presented for the information of GTWA management in the Schedule of Findings beginning on page 13. Of the 16 findings, five (5) are related to noncompliance with laws and regulations while the remaining 12 are internal control issues. Findings Nos. 6 through 8 are considered to be material weaknesses.

Following is a summary of the audit findings for the year ended September 30, 2005:

- (1) Finding Nos. 1 through 5 pertains to noncompliance with certain provisions of its enabling legislation relating to the terms of membership and duties of the board of directors.
- (2) Findings Nos. 6 through 14 discusses the absence of accounting policies and procedures which has resulted in inadequate maintenance and upkeep of basic accounting and financial records.
- (3) Findings Nos. 15 and 16 relates to inadequate supporting documentation for certain FY05 accounting transactions.

The management of GTWA has reviewed and agreed with the audit findings and related recommendations. GTWA's written response is presented as part of the audit report beginning on page 23.

We thank the Board of Directors and the staff of the GTWA for their responsiveness to our audit recommendations and for displaying the willingness to improve the management and operation of the Gagil-Tomil Water Authority.

Gertrude Gootinan
Yap State Public Auditor
November 8, 2006

GAGIL-TOMIL WATER AUTHORITY

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Gagil-Tomil Water Authority:

I was engaged to audit the accompanying balance sheet of Gagil-Tomil Water Authority as of September 30, 2005, and the related statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the GTWA's management. My responsibility is to express an opinion on these financial statements based on my audit.

The GTWA has not maintained adequate accounting records for the year ended September 30, 2005, and I was unable to apply procedures to determine whether the opening balances in the financial statements as of October 1, 2004 were fairly presented in conformity with accounting principles generally accepted in the United States of America or whether accounting principles have been consistently applied between fiscal year 2005 and 2004.

Since GTWA did not maintain adequate accounting records, and I was unable to satisfy myself about the opening balances in the financial statements as of October 1, 2004, or about the consistent application of accounting principles between fiscal year 2005 and 2004, the scope of my work was not sufficient to enable me to express, and I do not express, an opinion on its financial position as of September 30, 2005 and the results of its operations and cash flows for the year then ended, or on the consistency of application of accounting principles with the preceding year.

GTWA declined to present a statement of cash flows for the year ended September 30, 2005. Presentation of such statement summarizing the GTWA's operating, investing, and financing activities is required by accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 2 through 4 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. I have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurements and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, I have also issued a report dated April 25, 2006 on my consideration of the Gagil-Tomil Water Authority's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of my testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.

Gertrude Gootinan
Yap State Public Auditor

April 25, 2006

Gagil-Tomil Water Authority

Management Discussion and Analysis

As of September 30th, 2005

Overview:

This is the first audit performed for the Gagil-Tomil Water Authority (GTWA) since established in 1984, a period of 22 years. Because of the significant gap in an otherwise annual auditing and reporting, the number of related issues that had transpired, plus the fact that none of the existing board members, management nor staff had continued with the Authority over this interval; the board deemed this audit a key achievement to provide the procedures and means for the Board and Management to oversee the financial affairs of the Authority in a manner consistent with established processes; necessary to support, carry on and eventually, expansion of a viable Authority. GTWA has weathered the first electrical rate increase effective January 2005 with the then installed new water rates; however, further financial strain is anticipated in the next ensuing year, with a second electrical rate increase in March 2006 coupled with ever increasing fuel cost.

Financial Highlights:

- **Revenues** - At \$46.0 thousand for the year, it comprises of the new water rate imposed by the board in November 1st, 2002. The new rates as well as stricter payment terms, were established when the board recognized that increasing electrical costs and non payment by customers were adversely affecting the cash-flow of the Authority. This was the second Revenue adjustment made by the Authority, since Government turnover 22 years ago.
- **Expenses** for the Authority is strictly controlled by the Board. Several board members have direct signing authority over the three established bank accounts and usually the main topic of discussions between the board and management in its monthly meetings. Total expenses for the Authority represents \$0.82 of every \$1.00 in Revenues. The two most expensive line items for GTWA is the Personnel and Utilities (electrical) costs.
- **Net Income** - The year ended with a net increase in asset of \$8,356. This represents a gain of \$0.18 for every dollar earned for the year; however, external increases in electrical and fuel costs, including internal pressure to maintain and expand the system, as well as to upgrade and fairly compensate the staff, is putting additional financial burden on the Authority.

Gagil-Tomil Water Authority

**Management's Discussion and Analysis
September 30, 2005**

	<u>2005</u>
Assets	
Current Assets	\$ 25,121
Property and equipment, net	<u>6,611</u>
	<u>31,732</u>
Liabilities and Net Assets	
Current Liabilities	2,477
Net Assets	<u>29,255</u>
	<u>\$ 31,732</u>
Revenues, Expenses and Changes in Net Assets	
Operating Revenues	45,608
Operating Expenses	37,252
Loss from Operations	8,356
Nonoperating revenues	-
Increase/(decrease) in net assets	<u>8,356</u>

Plan of Action for 2006:

The Board and Management of GTWA have identified the following issues important and required for the continued operations of the Authority.

- Review and advise the nominating authority on all board members terms of appointment/expiry, to determine changes if any.
- Implement double-entry accounting system for the Authority.
- Train management and staff on the new accounting system.
- Continue review and analysis of all expenses to determine cost-savings for the Authority.
- Assessment of existing water rates in light of increasing electrical and fuel costs.
- Expansion of the System, by working with other Government agencies and municipalities in implementing the FSM-ADB Omnibus project.
- Work with other agencies on water quality and condition.
- Identify, analyze and implement other viable but related projects to provide alternative sources of revenues.

GAGIL-TOMIL WATER AUTHORITY

Balance Sheet
September 30, 2005

	<u>2005</u>
ASSETS	
Current assets:	
Cash	\$ 18,178
Trade receivables, (note 2)	4,313
Employee receivables, net of an allowance of doubtful accounts of \$0	1,392
Purchase order advance	<u>1,238</u>
Total current assets	25,121
Property and equipment, net (note 3)	<u>6,611</u>
TOTAL ASSETS	<u><u>\$ 31,732</u></u>
LIABILITIES AND NET ASSETS	
Current liabilities:	
Accounts payable	\$ 2,104
Accrued payroll	<u>373</u>
Total current liabilities	2,477
Contingencies	
Net assets:	
Invested in capital assets	6,611
Unrestricted	<u>22,644</u>
Total net assets	<u>29,255</u>
TOTAL LIABILITIES AND NET ASSETS	<u><u>\$ 31,732</u></u>

See accompanying notes to financial statements

GAGIL-TOMIL WATER AUTHORITY

Statements of Revenues, Expenses and Changes in Net Assets For the Year ended September 30, 2005

	<u>2005</u>
Operating revenues	
Water utility sales	\$ 43,837
Other sales	1,642
Interest income	129
	<hr/>
Total operating revenues	45,608
Operating expenses	
Salaries and benefits	11,906
Utility expense	11,652
Other expense	3,410
Depreciation expense	2,748
Repair & maintenance expense	2,739
Fuel	2,346
Office supplies	934
General and administrative	842
Contractual services	675
	<hr/>
Total operating expenses	37,252
Income from operations	8,356
Nonoperating revenues/(expenses)	--
Net income	8,356
Restatement of beginning net assets:	
Net assets as of September 30, 2004	70,205
Less : Partial cost of water system, net of accum. depr.	(53,716)
Add: Net effect of other prior period adjustments	4,410
	<hr/>
Net assets at beginning of year	20,899
Net assets at end of year	<u>\$ 29,255</u>

See accompanying notes to financial statements

GAGIL-TOMIL WATER AUTHORITY

Notes To Financial Statements
September 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity – The Gagil-Tomil Water Authority (GTWA) was created in 1984 pursuant to Yap State Law (YSL) No. 1-183 which is codified as Chapter 6 of Title 18 of the Yap State Code to “carry on the business of establishing, developing, maintaining, operating, and managing the Gagil-Tomil Water System. The GTWA is a legally separate entity of the State of Yap.

GTWA is governed by a nine-member Board of Directors with four members each from the two municipalities of Gagil and Tomil appointed by the municipalities’ representatives on the Council of Pilung, after consultation with village chiefs. The ninth member is appointed by the Governor and should not be from either Tomil or Gagil. The chiefs’ appointees to the Board of Directors hold 3-year terms, while the Governor’s appointee has a four-year term. The daily affairs of the Authority are carried out by two meter readers and an administrative assistant with full-time supervision by a member of the Board of Directors.

Basis of Accounting - GTWA utilizes accounting principles generally accepted in the United States of America as is applicable to proprietary funds of governmental entities. Such funds are accounted for using the flow of economic resources measurement focus. Thus, revenues are recorded when earned and liabilities at the time expenses are incurred.

Accounting Standards – 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 Principle Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989. GTWA has implemented GASB 20 and elected not to apply FASB Statements and Interpretations issued after November 30, 1989.

GASB Statement No.34 (*Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*) establishes standards for external financial reporting for state and local governments and requires that resources be classified for accounting and reporting purposes into four net asset categories:

- (a) **Invested in capital assets, net of related debt** - Capital assets, net of accumulated depreciation, and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets)
- (b) **Nonexpendable** – Net assets subject to externally imposed stipulations that require the GTWA to maintain them permanently.
- (c) **Expendable** – Net assets whose use by the GTWA is subject to externally imposed stipulations that can be fulfilled by actions of the Bureau pursuant to those stipulations or that expire by the passage of time.

GAGIL-TOMIL WATER AUTHORITY

Notes To Financial Statements September 30, 2005

- (d) **Unrestricted** – Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

The GTWA does not have restricted net assets as at September 30, 2005.

GASB No. 34 establishes a new financial reporting model that includes management's discussion and analysis, which is required supplementary information to the basic financial statements, and the presentation of net assets and changes in net assets in comparative financial statements.

New Accounting Standards – For fiscal year 2005, GTWA implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures (an amendment to GASB Statement No. 3)*. The impact of GASB Statements No. 40 was not significant to the financial statements.

For fiscal year 2006, GTWA will be implementing GASB Statement No. 46, *Net Assets Restricted by Legislation*. Management does not anticipate that implementation of GASB Statement No. 46 will have a material financial statement impact.

Cash – For purposes of the balance sheet and statement of cash flows, cash represents cash on hand and cash on deposit in a bank account. \$4,311 of the \$18,178 of the cash balance for the year ended September 30, 2005 are fully collateralized as such are subject to Federal Deposit Insurance Corporation (FDIC) coverage.

Accounts Receivables – Accounts Receivable as of September 30, 2005 are current due to GTWA's strict policy on collections.

Depreciation – Property and equipment is stated at cost less accumulated depreciation. Routine maintenance and repairs are expensed as incurred. Depreciation is recorded in the financial statements using the straight-line method over the estimated useful lives of the assets as follows:

Furniture and fixtures	2-6 years
Office equipment	3-5 years
Automobile	3 years

The Authority has not formally adopted a policy on capitalization of assets, but follows a general rule of capitalizing assets with costs in excess of \$50 and estimated useful lives of at least two years.

Use of Estimates – The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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

GAGIL-TOMIL WATER AUTHORITY

Notes To Financial Statements
September 30, 2005

reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

2. RECEIVABLES:

All of the trade receivables of GTWA as of September 30, 2005 are from Gagil and Tomil municipalities water customers as follows:

	<u>2005</u>
Tomil customers	\$ 2,694
Gagil customers	<u>1,619</u>
Allowance for bad debts	<u>--</u>
	\$ <u>4,313</u>

3. PROPERTY & EQUIPMENT

A summary of property and equipment as of September 30, 2005 follows:

	Beginning balance October 1, 2004	Transfers and Additions	Transfers and Deletions	Ending Balance September 30, 2005
Warehouse	15,091	--	--	15,091
Vehicle	4,632	--	--	4,632
Office equipment	3,113	78	--	3,191
Pump relay	842	--	--	842
	<u>23,678</u>	<u>78</u>	<u>--</u>	<u>23,756</u>
Less accumulated depreciation	<u>(14,397)</u>	<u>(2,748)</u>	<u>--</u>	<u>(17,145)</u>
Total	\$ <u>9,281</u>	\$ <u>(2,670)</u>	\$ <u>--</u>	\$ <u>6,611</u>

Not included in property, plant and equipment is the cost of the GTWA water distributions system which the State of Yap has included in its financial statements for fiscal year 2005.

4. FEMA GRANT

GTWA received through the State Government a FEMA Grant, check no. 16729 in the amount of \$3,634.63 for reimbursement of expenses incurred from Typhoon Sudal in April 2004. The transaction only impacts the cash account for fiscal year 2005.

GAGIL-TOMIL WATER AUTHORITY

Notes To Financial Statements
September 30, 2005

5. OTHER EXPENSES

Provided below is a breakdown of other expenses for the year ended September 30, 2005:

	<u>2005</u>
Miscellaneous	1,623
Quickbooks program	408
Pitamil reimbursement	837
Consummable goods	<u>542</u>
	\$ <u>3,410</u>

6. RELATED PARTY TRANSACTIONS

In the ordinary course of business, GTWA enters into transactions with the State Government and private businesses in which certain of the GTWA board members hold positions of influence.

7. RISK MANAGEMENT

GTWA is self-insured for all risks. Any loss or liability that may result upon occurrence of a natural disaster, accident or litigation will be borne entirely by GTWA. Management is of the opinion that no material losses have been sustained as a result of this practice.

8. SUBSEQUENT EVENT

The State of Yap signed on March 8, 2006 an agreement with the Asian Development Bank for an ADB Omnibus loan of approximately \$3.6 million for the upgrading of the GTWA existing water distribution system and expansion to Makiy viillage in Gagil and Maap Municipality. A portion of the loan proceeds is earmarked for capacity building for GTWA employees.



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INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON THE AUDIT PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors of
Gagil-Tomil Water Authority:

I was engaged to audit the financial statements of Gagil-Tomil Water Authority (GTWA) as of September 30, 2005, and for the year then ended, and have issued my report thereon dated April 25, 2006 which opinion was a disclaimer due to inadequate accounting records and uncertainties regarding opening balances and consistent application of accounting principles between fiscal year 2005 and 2004. I conducted my 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 Controls over Financial Reporting

In planning and performing my audit, I considered GTWA's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control over financial reporting. My 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 reportable 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 might 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. Matters involving the internal control over financial reporting and its operation that I consider to be material weaknesses are reported in the Schedule of Findings as Finding Nos. 6 through 8. I have also reported other matters involving the internal control over financial reporting to management in the accompanying Schedule of Findings as Findings Nos. 9 to 16.

Compliance

As part of obtaining reasonable assurance about whether GTWA's financial statements are free of material misstatements, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards*, which are presented in the Schedule of Findings as Findings Nos. 1 to 5.

This report is intended for the information of the management and Board of Directors of the Gagil-Tomil Water System and is not intended to be and should not be used by anyone other than these specified parties. This report, however, is a matter of public record and its distribution is not limited.

Gertrude Gootinan
Gertrude Gootinan
Yap State Public Auditor

April 25, 2006

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 1 – Organization of the Board

Criteria: The Yap State Code, Chapter 6 of Title 18, Sub-chapter III section 653 states *“The Board shall organize by electing one of its members as Chairman and the Chairman shall appoint a Vice-Chairman, a Secretary to keep the minutes and records of the Board, who shall be a member of the Board itself.”*

Condition: The Gagil-Tomil Water Authority (GTWA) administrative assistant is responsible for taking board meeting minutes and preparing them for adoption by the Board of Directors. In her absence from a board meeting, one of the Board members would then be responsible for keeping minutes.

Cause: The Chairman did not assign one of the Board members to be secretary of the Board of Directors and be responsible for taking board meeting minutes as was specified in Title 18 Chapter 6 of the Yap State Code.

Effect: Due to the Board decision to task the administrative assistant with the responsibility of secretary of the Board to take accurate board meeting minutes and prepare them for adoption, the Board of Directors did not abide by the Gagil-Tomil Water Authority’s enabling legislation.

Recommendation: We recommend the Chairman of the Board appoint a Secretary of the Board and ensure that written minutes for all meetings held by the Board are kept with details sufficient to provide the reader information on what, how and why the Board took certain actions and made particular decisions. After the Board as a whole has reviewed and approved the minutes as the final documentation of its proceedings, a certified copy of the minutes should be provided to GTWA to be filed for future reference.

Finding No. 2 –Board of Directors’ Term

Criteria: The Board of Directors is responsible for ensuring that GTWA is in compliance with their enabling legislation and other State regulations and policies applicable to the Authority. GTWA enabling legislation addresses the term of GTWA Board members as three years for Gagil and Tomil Board members and a four-year term for the Governor appointee on the Board.

Condition: The current Board of Directors did not have any documentation to state when they were appointed to the Board by the Council of Pilung representatives from Gagil and Tomil or by appointment by the Governor.

Cause: The members of the Board of Directors did not thoroughly review the enabling legislation to assure that they are in compliance with State Law and requirements.

Effect: There is no document to confirm when the current Board members were appointed to the GTWA Board. In addition, some of the board members may not be in compliance with the GTWA enabling legislation on the terms of the Board members.

Recommendation: We recommend that the Board of Directors go over the GTWA enabling legislation and ensure they are in compliance with it and other State Laws applicable to GTWA. Moreover, board members should require that sufficient documentation be maintained on file to allow the length of service of each board member to be readily determined.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 3 – Enforcement of Board Decisions

Criteria: The Board of Directors has the responsibility to oversee the best interests of GTWA and ensure proper authorization of transactions is evident to safeguard GTWA's resources and maintenance of such assets.

Condition: A Board subcommittee was approved to oversee employee timesheets, vehicle authorizations and approval of purchases exceeding \$100. We found no evidence of such oversight in place during fiscal year 2005. In addition, per board meeting minutes dated January 23, 2005, the Board made the decision to use \$250 for GTWA anniversary gathering. Our review found that anniversary-related disbursements incurred on February 4th and 6th, 2005 totaled \$542.

Cause: There was no follow-up by the Board to make certain that management and staff were in compliance with guidelines set forth in board meetings on daily GTWA operations and disbursements on GTWA functions such as the anniversary gathering.

Effect: GTWA employees were not required to use timesheets to record actual time earned and authorizations on the vehicle and approval of purchases were inconsistent with board instructions. Moreover, GTWA exceeded the level of spending authorized by the Board for the anniversary gathering.

Recommendation: We recommend the Board to be consistent with final decisions made and adopted from Board of Directors meetings and ensure that management and staff are following directives agreed upon by the Board to be implemented by GTWA employees.

Finding No. 4 – Official Board Actions

Criteria: Only decisions and actions by a quorum of the members of the Board of Directors during an officially recognized meeting of the Board of Directors are binding on GTWA.

Condition: Our review of payroll disbursements found that from pay period three (3) paid on February 11, 2005, the three GTWA employees received a combined sum of \$721.04 in salary increases over their regular wages for the prior pay periods. The increase was in effect from pay period three (3) to pay period six (6) only.

Cause: According to the employees, the Board of Directors authorized the pay increase. However, our review of Board minutes did not find any documentation of the raise approved by the Board.

Effect: In a meeting held on March 16, 2005, the Board of Directors declared the salary increase implemented by employees on February 11, 2005 to be unauthorized and should be reimbursed by employees through payroll deductions. The amount was still outstanding as of September 30, 2005. We found that attempts to withhold \$50 each for two employees during one pay period ended up disbursing the amounts to the employees instead. As a result, as of September 30, 2005, GTWA employees owed \$1,392 to GTWA for the unauthorized pay raise and the subsequent error.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 4 (Cont.)

Recommendation: We recommend the Board documents its official decisions in the form of resolutions to prevent the above misunderstandings from recurrence in the future and to protect itself against abuse of power by any one member. Moreover, employees should be instructed that unless the authorization that appears in the form of a properly documented Board resolution, verbal authorizations given by any member of the Board of Directors should not be regarded as legally binding.

Finding No. 5 – Effective Management

Criteria: Ideally, the Board of Directors should be responsible for setting organizational goals and objectives and establishing policies to ensure the achievement of the stated goals and objectives. The day to day operation is normally delegated to a general manager. Title 18 of the Yap State Code, Chapter 6 subchapter III section 655, states the powers and duties of the manager as follows:

- (1) *“To ensure that all rules and regulations of the Authority are enforced,*
- (2) *To attend all meetings of the Board to submit a general report on all affairs of the Authority,*
- (3) *To keep the Board advised on the needs of the Authority,*
- (4) *To approve demands for payment of obligations within the purposes and amounts authorized by the Board,*
- (5) *To prepare or cause to be prepared all plans and specifications of the operation and maintenance of works and facilities operated by the Authority,*
- (6) *To devote his entire time to the business of the Authority,*
- (7) *To cause to be published within sixty days after the end of each fiscal year a financial status of the Authority on the last day thereof, publication shall be made in the manner provided by the Board,*
- (8) *To perform such other and additional duties as the Board may require; and*
- (9) *To be an ex-officio non-voting member of the Board.”*

Condition: GTWA had three full-time permanent employees – two meter readers and an administrative assistant. During fiscal year 2005, the Board of Directors assigned the duties of general manager and assistant manager to the two meter readers. Yet the Board continued to be responsible for many of the management functions. In May 2005, a subcommittee of Board members was tasked to approve labor contracts, vehicle authorizations, and timesheets, and purchases over \$100. In addition, in January 2006, the Board placed one of its members on payroll for a sixth-month term to “provide overall supervision, coordination, and directive to management, work with communities in the respective municipalities in improving the water system, research information and develop project proposals for diversification of GTWA, and represent the Authority to official functions.”

Cause: The Board’s close supervision of daily operations is warranted to some degree. Due to the lack of adequate segregation of duties given the small size of GTWA, independent review of financial activities is necessary. Moreover, because the Board members individually possess greater management experience than the employees, the Board may be reluctant to surrender all managerial functions to the new manager and his assistant.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 5 (Cont.)

Effect: The overlapping of management responsibilities between the Board of Directors and the general manager and his assistant makes for an ineffective management structure. When important tasks are left undone, because the Board has assumed responsibilities for those tasks, no one is left in the organizational hierarchy to hold anyone accountable for nonperformance. Consequently, of the managerial tasks enumerated in GTWA's enabling legislation, we found inadequate coverage of item numbers (1), (5) and (7) during fiscal year 2005.

Recommendation: We recommend that the Board of Directors establish the guidelines and policies for the Authority by having clear objectives for management and to monitor them by means of periodical evaluations to ensure effective and efficient management is in place for GTWA. The day to day operation and supervision of employees should be delegated to a capable general manager. The clear delineation of roles for the Board and management would prevent conflicts of interest that would inevitably arise when members of the Board are placed in a position to monitor its own activities.

Finding No. 6 – GAAP Bookkeeping and Accounting System

Criteria: GTWA management is responsible to ensure that the Authority maintains and makes available reliable and accurate accounting and financial records maintained in accordance with generally accepted accounting principles (GAAP).

Condition: GTWA did not maintain its bookkeeping and accounting system on a basis consistent with the following basic accounting principles:

- (1) *GAAP requires the use of double-entry accounting where each transaction is recorded both as a debit and credit to at least two related accounts in the general ledger.* This ensures that financial statements prepared from the accounting data would always be in balance, increasing the chances to detect errors in a timely fashion. GTWA did not use double-entry accounting during fiscal year 2005.
- (2) *GAAP requires the use of a general ledger, a set of accounts utilized to keep track of five essential categories of accounting data: assets, liabilities, net assets, revenues and expenses.* GTWA did not have sufficient accounting information maintained for each of the essential category of accounting data, most especially assets, liabilities and net assets.
- (3) *GAAP requires revenues to be recorded when earned and measurable and liabilities at the time that expenses were incurred (goods and services were received).* This is called the accrual method of accounting. GTWA recorded revenues and expenses on the cash-basis method of accounting – recording revenues and expenses only when cash is received or disbursed.
- (4) *GAAP requires the proper matching of revenues and expenses for each accounting period.* This requires assets or expenses benefiting more than one period to be capitalized and amortized over the number of periods that the asset or expense is expected to contribute towards the generation of income. Because it was on a cash-basis accounting method, GTWA was not able to comply with this basic accounting principle.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 6 (Cont.)

- (5) *GAAP requires the consistent recording of accounting transactions from one period to the next.* To ensure that financial data from one period are comparable with those of past or future periods, the same types of transactions should be recorded to the same account from period to period. A standard chart of accounts comprising the general ledger ensures that similar transactions are recorded consistently between different accounting periods. GTWA did not have a chart of accounts in place during fiscal year 2005.
- (6) *GAAP requires the consistent recording of accounting transactions from one period to the next.* To ensure that financial data from one period are comparable with those of past or future periods, the same types of transactions should be recorded to the same account from period to period. A standard chart of accounts comprising the general ledger ensures that similar transactions are recorded consistently between different accounting periods. GTWA did not have a chart of accounts in place during fiscal year 2005.

Cause: There is no trained accountant at GTWA to set-up and maintain a GAAP accounting system from which financial statements could be prepared. In the past, we had recommended to GTWA that they purchase an accounting software for their bookkeeping needs which they did in December 2004. However, GTWA has yet to utilize the software for its bookkeeping functions, having not found anyone to help them set up the program.

Effect: The financial statements submitted by GTWA were not prepared in accordance with generally accepted accounting principles. The balance sheet did not balance because there was no amount shown for net assets. There was no way to tie beginning balances for assets and liabilities to the prior periods because of inadequate maintenance of these types of accounts. Accounts comprising the Statements of Revenues and Expenses included activities of prior periods because of GTWA's cash basis of accounting. Moreover, Statement of Revenues and Expenses prepared by GTWA did not show the change in net assets as required by GAAP.

Due to the above problems, we had to compile GTWA's financial statements ourselves using information obtained from banks, vendors, and GTWA collection and disbursement records. Because we had prepared the financial statements ourselves, auditing standards prevented us from issuing an opinion on the audit for GTWA as we could not audit our own work.

Recommendation: We recommend the Board of GTWA take appropriate action to utilize the *Quickbooks* program purchased in December 2004 for the Authority's accounting. The beauty of the program is that it is designed to allow nonaccountants to maintain bookkeeping and accounting records that meet the basic accounting standards. We cannot stress enough how important it is that the Board of Directors find someone as soon as possible to set up the program by creating a chart of accounts, establish beginning balances, and train the accounting clerk to post transactions to the program.

Finding No. 7 – Audit Trail of Transactions

Criteria: A sound accounting system provides for proper audit trail of transactions allowing individual transactions such as cash receipts and checks to be traced to their recording in books of original entry, posting to the general ledger and eventual summarization in the financial statement.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 7 (Cont.)

Condition: Instead of the normal general ledger and supporting subsidiary ledgers, GTWA haphazardly posted transactions to single page ledgers from which staff attempted to compile financial statements for FY05. However, because a double-entry accounting system was not in place, there was no assurance that all transactions were accurately posted. Moreover, two of the most important subsidiary ledgers such as the cash disbursement journal and cash receipts journal were not maintained.

Cause: None of the employees had the basic accounting and bookkeeping skills to maintain manual ledgers that could produce reliable accounting information.

Effect: There was no assurance that all checks issued and all cash received were posted accurately and classified properly in the accounting ledgers. Moreover, we experienced difficulty tracing ledger balances to the financial statements and vice versa.

Recommendation: GTWA must adopt double-entry accounting and establish and maintain a general ledger. We recommend that GTWA immediately find someone to assist them utilize the accounting software package already on hand. Otherwise, if GTWA elects to continue using a manual accounting system, then someone with sufficient accounting and bookkeeping skills should be hired to maintain the manual system.

Finding No. 8 – Bank Reconciliation

Criteria: A basic control of every accounting system is the regular reconciliation of the cash balance per bank to the account balance maintained in the general ledger.

Condition: GTWA did not perform bank reconciliation during fiscal year 2005. The nearest equivalent to a bank reconciliation that we found was a check register with a running balance that is occasionally compared to the bank's balance.

Cause: Because GTWA did not have a general ledger, there was no effective way to perform meaningful reconciliation of the bank account.

Effect: The lack of regular reconciliation of bank accounts to the general ledger balances increases the risk of errors and omission in the recording of transactions that may not be timely detected.

Recommendation: We recommend the GTWA Board to require the accounting clerk to make certain bank reconciliation is performed on a monthly basis.

Finding No. 9 – Employment Records

Criteria: Proper controls require written documentation of employees' authorized pay rates, employment benefits and other terms of employment.

Condition: Payroll transactions showed that GTWA neither utilized personnel action forms nor employment contracts to document employees authorized pay rates.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 9 (Cont.)

Cause: There were no formal job descriptions to define specific tasks required for job positions. The Board did not required management to adopt the use of employment contracts or personnel action forms to document in writing the terms of employment including authorized hourly rates for GTWA employees.

Effect: Not maintaining complete employment records increases the risk of unauthorized pay increases or employment benefits. In fact, because of the lack of personnel actions necessary to change pay rates, during fiscal year 2005, the employees implemented an unauthorized pay raise worth \$1,392 which as of September 30, 2005 had not been repaid to GTWA.

Recommendation: We recommend that the Board of Directors require the General Manager to immediately prepare employment contracts and personnel actions for employees at GTWA. Employee contracts would contain information on job descriptions and authorized hourly rates. GTWA can adopt the format of the State Personnel Action Form because such form has the basic information required to properly track initial date of employment, changes in pay rates and other relevant information pertaining to employee evaluations.

Finding No. 10 – Customer Master Lists

Criteria: GTWA should be able to provide details to support financial statement balances.

Condition: Without a general ledger, we had to rely on the monthly master lists of customer billings to verify the sales for fiscal year 2005 as reported by GTWA. However, our review of the master lists showed that revenue reported by GTWA in its financial statements did not agree with actual billings on file.

Cause: Management was not required to review monthly billings prepared by administrative assistant to verify reliability of customer records before delivery of bill and ensure that copy filed at GTWA Office included grand totals of total billing amount, previous account balance, payments, balance after payment and new account balance. Moreover, customer numbers did not sort the master lists.

Effect: The lack of accurate and complete master lists increases the risk of errors and misstatements in the financial statements. GTWA compilation of FY 05 financial statements was unreliable.

Recommendation: We recommend that GTWA Board require Management to review all monthly customer billings to make sure they are accurate, complete, and reliable. Gagil and Tomil monthly master lists should include subtotals and grand totals of customer accounts. Billings should be sorted by customer number and includes proper monthly heading for each billing.

Finding No. 11 – Supporting Documentation

Criteria: Proper controls require that sufficient supporting documentation is available for management's review before cash is disbursed.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 11 (Cont.)

Condition: GTWA check no. 1095 dated September 30, 2005 was made payable to Pitamil, the Tomil community association, in the amount of \$837. The supporting supplier invoice for the payment found on file was not from Pitamil, but indicated GTWA to be the supplier. Inquiries found that the \$837 was intended to be a reimbursement to the Pitamil Association for tin roofing the Association supplied to GTWA in the aftermath of Typhoon Sudal for the repair of the GTWA Monguch office. GTWA obviously did not require the Pitamil Association to provide an invoice for the materials the Association provided to GTWA. Consequently, there was no documentation on which to base the GTWA reimbursement to Pitamil. Therefore, employees devised an invoice which, unfortunately, listed GTWA as the supplier instead of Pitamil.

Cause: GTWA apparently had no policies in place requiring adequate underlying supporting documentation for disbursement checks.

Effect: Insufficient underlying supporting documentation increases the risk of fraud, abuse, and errors in the accounting records.

Recommendation: We recommend that GTWA should ensure that an invoice from the payee indicating the cost of goods and services and acknowledgement that GTWA has received the goods and services are filed to support each disbursement transaction.

Finding No. 12 – Spare Parts Inventory

Criteria: Proper controls should be in place to ensure a properly costed spare part inventory listing exists for items available in stock.

Condition: Because management was not required to have a reliable spare parts inventory listing on hand, the spare parts inventory listing submitted by GTWA was not costed and included both fixed assets such as Office Equipment and spare parts.

Cause: GTWA management was not required to maintain an accurate accounting for its Spare Parts Inventory to ensure issuance of stock is documented including purchased made on Inventory additions.

Effect: Because there was no control measures in place to keep track of inventory, GTWA spare parts inventory listing is incomplete and unreliable for auditing purposes.

Recommendation: We recommend that the Board of Directors require management and staff to maintain a costed spare parts inventory listing and include supporting documentation on new additions and issuance of stock which would then result in a reliable listing of GTWA assets.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 13 – Fixed Asset Register

Criteria: An effective systematic fixed asset register is required for GTWA to maintain proper control over its property and plant assets.

Condition: There was no fixed asset register maintained at GTWA for its property and plant assets.

Cause: The Board did not required management to maintain reliable Fixed Asset Register for GTWA. Management and staff were not required to maintain reliable accounting records on fixed assets.

Effect: FY 05 financial statements compiled by GTWA and submitted to OPA were incomplete without property and plant totals and therefore contained unreliable financial information.

Recommendation: We recommend that the Board of Directors require management and staff to set up and maintain reliable fixed asset registers including having a fixed asset capitalization policy to make sure consistent accounting record is in place.

Finding No. 14 – Aged Customer Receivables

Criteria: A sound system of accounting allows preparation of an aged schedule of customer receivables.

Condition: GTWA was unable to provide an aged schedule of customer receivables as of September 30, 2005. Therefore, based on representation made by employees and board members of the nonexistence of delinquent accounts over 60 days, we used the 'Prior Account Balances' from the October 2005 billing master lists as the basis for the September 30, 2005 receivables.

Cause: GTWA's accounting system was not designed to provide information on the age of customer receivables, therefore, such information was not available. Moreover, sales were recorded not on amount billed, but on amount collected, therefore, reliable receivable balances on a basis consistent with generally accepted accounting principles were not available.

Effect: We were not able to confirm that the September 30, 2005 Tomil customer receivables of \$2,694 and \$1,619 from Gagil were actually less than a year-old as represented by GTWA.

Recommendation: We recommend that the Board of Directors require staff to maintain accounting of sales and collections in a manner to allow for the aging of receivable balances. Again, the *Quickbooks* accounting package would facilitate the maintenance of customer receivable balances consistent with generally accepted accounting principles.

Finding No. 15 – Unreasonable selling price

Criteria: GTWA Management is responsible for safeguarding GTWA's resources and for ensuring the losses to the Authority is minimized.

Condition: A moped purchased in December 2004 for \$295.00, repaired during the year at a cost of \$75, was sold less than a year later in October 2005 at \$75.05. GTWA incurred loss on the sale of \$294.95.

GAGIL-TOMIL WATER AUTHORITY

Schedule of Findings
September 30, 2005

Finding No. 15 (Cont.)

Cause: The Board of Directors authorized GTWA staff to bid out the moped and sell it to highest bidder. Management did not establish a minimum bid.

Effect: GTWA incurred a loss of \$294.95 on the sale as there was no controls set by the Board to direct management by a guarantee of a favorable sale for the Authority.

Recommendation: We recommend that GTWA board require management to have reasonable price on reconditioned items for the Authority.

Finding No. 16 – Noncash Exchanges

Criteria: Proper controls should be in place to ensure that accounting information is complete, accurate, and reliable.

Condition: In the aftermath of Typhoon Sudal when island-wide power was disrupted, FEMA supplied GTWA with a generator and fuel to operate the pump station in order to provide water to its customers. According to a note prepared by a GTWA employee and signed by the acting chairman, when YSPSC restored electricity to the pump station, the FEMA generator was removed, but two 55-gallon drums of fuel were left behind over which GTWA assumed ownership. Since GTWA had no need for the fuel without a generator, they elected to trade it off for two cell phone units from a local vendor. The sale of the fuel and purchase of the cell phones worth \$264 were not recorded in the accounting records.

Cause: GTWA recorded its accounting transactions on a cash basis using receipts and checks as source documentation for the recording of sales and expenses. The exchange above did not involve cash; therefore, it was not recorded to the accounting records.

Effect: Noncash transactions increase the risks of errors and omissions in the accounting records. Moreover, there was no documentation of the sale proceeds from the fuel, therefore, no way to verify whether GTWA got a fair exchange.

Recommendation: We recommend that the Board of Directors ensure that GTWA refrain as much as possible from noncash exchanges. Assets available for sale should be sold for cash and the proceeds subsequently used to purchase needed items. This allows the accounting clerk to record both the sale and expense.

GAGIL TOMIL WATER AUTHORITY

Responses to the Schedule of Findings September 30, 2005

Finding No. 1 – Organization of the Board

The Board reviewed this finding and the Chairman will appoint a member to be the board Secretary no later than July 28, 2006 to perform all duties and responsibilities as prescribed in the existing enabling legislation.

Finding No. 2 – Board of Directors' Term

The Board has already informed the Governor and the two municipal chiefs about this finding, and now awaiting for their nominees on the Board to submit in writing. A copy of their nominees on the board will be documented and maintained on file to allow length of services for each board member. .

Finding No. 3 – Enforcement of Board Decision

The Board will re-enforce itself to be consistent with all decisions made and adopted in its board meeting, and will remind the management and staff to ensure to implement directives accordingly.

Finding No. 4 – Official Board Actions

The Board will instruct employees that no administrative actions will be taken unless such action is official and in a form of resolution by the Board of Directors. In addition, the Board will take necessary actions to recover from loss incurred in this particular incident or impose disciplinary actions to prevent such misconduct in the future. A subcommittee is assigned to look into this problem and will report back on 7/5/06.

Finding No. 5 – Effective Management

The Board has reviewed this finding and concurs to come up with an organizational chart with job description of its positions to ensure the overlapping of responsibilities is not happening in the future. Furthermore, the board will instruct the general manager to review the existing enabling legislation to ensure his duties and responsibilities are in compliance and performed accordingly.

Finding No. 6 – GAAP Bookkeeping and Accounting System

Referred to finding No. 8

Finding No. 7 – Audit Trail of Transactions

Referred to Finding No. 8

Finding No. 8 – Bank Reconciliation

The Board has combined and reviewed Findings No. 6, 7, and 8. The Board discussed these findings with GTWA management and staff and concluded to follow the auditor recommendations and install the Quick Book software. A part of the accounting software has already been installed and the management and staff are in the process to complete it before the 4th quarter of Fy 2006. The Board agreed that after installing the accounting software GTWA will contract an accountant with knowledge on this software to train the general manager and key staff.

Finding No. 9 – Employment Records

The Board reviewed this finding and decided to assign one of its board members to assist the general manager to look into the Public Service System Act and the State Personnel Action Form to make sure that the hiring procedure and the employee benefits are comparable with Yap State Government. This would include the job descriptions, hourly rates, sick and annual leave, vacation, employees' evaluation, and insurance policy.

Finding No. 10 – Customer Master List.

The Board reviewed this finding and recommended to the general manager to carefully review all customer billings to ensure the billings are accurate, complete, and reliable before distributing them to customers. With the Quick-Book fully installed the Board hopes the general manager and staff would be able to track down customers' outstanding balances, and the monthly master list would be able to indicate subtotals and grand totals of customer accounts.

Finding No. 11 – Supporting Documentation

The Board concurs to instruct the general manager to make sure that any transactions related to invoices, purchase of goods, services, and disbursements are properly issued, documented, and filed.

Finding No. 12 – Spare Parts Inventory

The Board reviewed this finding and agreed to instruct the general manager to ensure that all spare parts stock are recorded and cost out accordingly. The Board also required the general manager to input all spare parts stock in the accounting software to easily track down new additions and issuance of stock.

Finding No. 13 – Fixed Assets Register

The Board discussed this finding and required the management and staff to establish a reliable register on fixed assets, and to maintain an accounting record for the same. The Board will ensure the general manager and the staff will input all fixed assets in the accounting software for the purpose of registration and accounting records.

Finding No. 14 – Aged Customer Receivable

The Board agreed that as soon as the Quick Book software fully installed all customers' information will be transferred into the accounting software to easily monitor aged customer receivables. With this accounting software in placed sales can be recorded on amount billed to customers.

Finding No. 15 – Unreasonable Selling Price

The Board on this finding concurs and agreed to require the general manager to before bidding out any property of the Authority he must inform the Board to make sure the price is reasonable and all the bidding requirements of the State are satisfied.

Finding No. 16 – Non-cash Exchanges

The Board agreed to advice the management and staff to refrain from non-cash exchanges and will definitely follow your recommendations that any donated assets must be sold for cash in order to purchase needed office supplies or equipment.