

**Department of Resources and Development
Yap State Government**

**International Waters Project
Account No. A5.23.30.42.36503**

**Schedules of Activities and
Independent Auditor's Report**
Three Months Ended December 31, 2006 and
The Fiscal Years Ended September 30, 2006 and 2005



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

INTERNATIONAL WATERS PROJECT

TABLE OF CONTENTS

Three Months Ended December 31, 2006 and
The Fiscal Years Ended September 30, 2006 and 2005

Independent Auditor's Report	1
Schedules of Activities	3
Notes to Financial Statements	4
Independent Auditor's Report on Internal Controls over Financial Reporting and on Compliance and Other Matters Based Upon the Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	6
Schedule of Findings and Responses	8



OFFICE OF THE STATE PUBLIC AUDITOR

YAP STATE GOVERNMENT

Federated States of Micronesia

P.O. Box 927

Colonia, Yap FM 96943

Phone: (691) 350-3416 Fax: (691) 350-4987 Email: audit Yap@mail.fm

INDEPENDENT AUDITOR'S REPORT

To the Director
Department of Resources and Development
Yap State Government

We have audited the accompanying schedules of activities of the International Waters Project (the Project) Account No. A14-30-G0503 for the three months ended December 31, 2006 and the fiscal years ended September 30, 2006 and 2005. These financial statements are the responsibility of the Project's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, these financial statements presents fairly, in all material respects, the activities of the Project as of the three months ended December 31, 2006 and the fiscal years ended September 30, 2006 and 2005 in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 7, 2008, on our consideration of the Project's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide 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 considered in assessing the results of our audit.

This report is intended for the information and use of the management of the Project and the Yap State Department of Resources and Development and is not intended to be and should not be used by anyone other than these specified parties.



Ronald C. Yow
Acting Yap State Public Auditor

November 7, 2008
(except for Note 3, as to which
the date is May 19, 2011)

**DEPARTMENT OF RESOURCES & DEVELOPMENT
YAP STATE GOVERNMENT**

International Waters Project
Account No. A5.23.30.42.36503
Schedules of Activities

For the three-months ended December 31, 2006, and
the Fiscal Years ended September 30, 2006 and 2005

	Three Months Ended <u>12/31/06</u>	Year Ended <u>2006</u>	Year Ended <u>2005</u>
Revenues			
Transfer from Pacific Regional Environment Program through Federated States of Micronesia (FSM)	\$ 0	\$ 0	\$ 0
Other Revenue	<u>150</u>	<u>0</u>	<u>0</u>
	<u>150</u>	<u>0</u>	<u>0</u>
Expenses			
Salaries and Benefits	1,272	5,224	21,170
Contractual services	-	19,806	2,145
Car and equipment rental	-	-	1,870
Representation & entertainment	-	201	873
Communications	-	-	1,549
Printing and reproduction	-	-	986
Other expenses	494	1,439	547
Office supplies	177	142	224
Travel	-	-	2,626
Repair services	<u>-</u>	<u>435</u>	<u>79</u>
	<u>1,943</u>	<u>27,247</u>	<u>32,069</u>
Changes in net assets	(1,793)	(27,247)	(32,069)
Net deficits at beginning of year	<u>(83,680)</u>	<u>(56,433)</u>	<u>(24,364)</u>
Net deficits at end of year	<u>\$ (85,473)</u>	<u>\$ (83,680)</u>	<u>\$ (56,433)</u>

See accompanying notes to these financial statements

**DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT**

International Waters Project – Account No. A14-30-G0503

Notes to Financial Statements

For the Three Months Ended December 31, 2006 and

The Fiscal Years Ended September 30, 2006 and 2005

(1) Organization

Grant assistance to implement the South Pacific Environmental Program (SPREP) Strategic Action Program of the Pacific Small Island Developing States was provided for a pilot International Waters Project (IWP) in Yap. SPREP's long-term objective is to strengthen the management and conservation of marine, coastal, and freshwater resources in the Pacific islands region. IWP is an initiative involving 14 independent Pacific island states that qualify for Global Environment Facility (GEF) support. The grant, financed by the GEF and implemented by the United Nations Development Program (UNDP), was awarded based on a proposal submitted by Yap to promote sustainable coastal fisheries through a system of marine protected areas.

Under provisions of a memorandum of understanding (MOU) with SPREP as the regional executing agency for the strategic action program, the Federated States of Micronesia (FSM) as national executing agency committed the national government of FSM to supporting processes to address the objectives of the IWP in FSM and regionally. Subsequently, responsibility for technical implementation of the pilot project was delegated to the Yap State Department of Resources and Development (R&D) pursuant to a letter of agreement executed by and between the State of Yap, SPREP, and FSM.

(2) Summary of Significant Accounting Policies

Basis of Accounting

Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. The Project uses the accrual basis of accounting, under which revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Revenues

During the calendar year 2006, the Project entered into a contract with the Yap Institute of Natural Science to compile and publish a 2006 calendar featuring the marine protected areas of Yap. The calendars, which were developed to promote the objectives of the project, were placed at local establishments for sale to the general public at \$5 each.

**DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT**

International Waters Project – Account No. A14-30-G0503

Notes to Financial Statements

For the Three Months Ended December 31, 2006 and

The Fiscal Years Ended September 30, 2006 and 2005

(3) Subsequent Events

The IWP program was formally closed by the SPREP Secretariat in February 2007. A long-term objective of the program is to encourage the participating nations to conserve and sustainably manage their coastal and ocean resources. Accordingly, the Project continues to operate until all grant funding is expended. Expenses for fiscal years ending September 30, 2007, 2008, and 2009 were \$15,530, \$16,957 and \$3,080, respectively. The unexpended portion of grant funds as of September 30, 2009 was \$8,961. Additionally, though funding was allotted to the Project by the national government of FSM, only a portion of grant funds has been received, the first payment of which occurred in 2007. As of September 30, 2009 the Project's remaining balance of grant money due and receivable from FSM is \$37,276. The following is a reconciliation of unexpended funds and amount of grant funds still owing:

Total FSM allotment of Grant Funds	\$	130,151
Cumulative Expenses		<u>121,190</u>
Unexpended	\$	8,961
Total FSM allotment of Grant Funds	\$	130,151
Grant Funds Received		<u>92,875</u>
Due from FSM	\$	37,276

The Project recorded additional revenue of \$1,505 and \$300 from the sale of calendars in 2007 and 2008 respectively. Unsold calendars were given away as donations.



OFFICE OF THE STATE PUBLIC AUDITOR

YAP STATE GOVERNMENT

Federated States of Micronesia

P.O. Box 927

Colonia, Yap FM 96943

Phone: (691) 350-3416 Fax: (691) 350-4987 Email: audityap@mail.fm

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

To the Director
Department of Resources and Development
Yap State Government

We have audited the financial statements of the International Waters Project (the Project) Account No. A14-30-G0503 for the three months ended December 31, 2006 and the fiscal years ended September 30, 2006 and 2005 and have issued our report thereon dated November 7, 2008 (except for Note 2, as to which the date is May 19, 2011). We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Project's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Project's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Project's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying *Schedule of Findings and Responses*, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct material misstatements on a timely basis. A *material weakness* is a

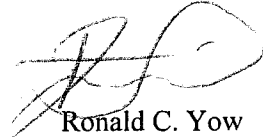
deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Project's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying *Schedule of Findings and Responses* as item 2006-1 through 2006-02 to be a material weakness.

A *significant deficiency* is a deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying *Schedule of Findings and Responses* as items 2006-07 and 2006-08 to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Project's financial statement is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, and which is described in the accompanying *Schedule of Findings and Responses* as item 2006-03 through 2006-05.

This report is intended for the information and use of the management of the Project and the Yap State Department of Resources and Development and is not intended to be and should not be used by anyone other than these specified parties.



Ronald C. Yow
Acting Yap State Public Auditor

May 19, 2011

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 1 – Improper Use of Funds

Criteria: Only legitimate and reasonable project expenses should be charged against the Project account.

Condition: Payments of expenses incurred by the Division of Marine Resources were charged to the project as follows:

- Utilities expenses of \$2,853 billed in 2009. The recording of these expenses was authorized by the Chief of Budget, Office of Planning & Budget (OPB) who issued specific instructions to expend these funds against the project accounts.
- Personnel expenses in 2008 of \$5,426 for a fisheries specialist. This individual is under contract, which has been extended from year to year, and has been employed by Marine Resources since at least 2005. During its existence, the Project had only two employees, both administrative, and never utilized the services of a marine specialist.

Cause: Justification for the recording of the utilities expense against the project was expressed in the letter from the Chief of Budget, who argued that funds had been received for a Marine Resources project which still had sufficient balance and that Budget and Finance will be working together to reconcile the account to allow Marine Resources to shift funds as needed to meet their expense. The Chief of Budget also authorized recording of personnel expenses for the Marine Resources employee against the Project.

Effect: Manipulation of expenses leading to misstatement of financial statements, improper budgets, and lack of accountability and transparency and abuse in the use of state funds.

Recommendation: Funds should not be obligated or disbursed towards expenses that have little to do with project operations, and these expenses for the Division of Marine Resources should have been budgeted and provided for by the Department of R&D. To properly reflect the economic substance of these transactions and ensure Project expenses are not overstated, request that OAS reclassify these to the proper accounts.

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 2 – Unaccounted for Equipment

Criteria: Government property and equipment should be accounted for at all times.

Condition: A Dell desktop computer purchased from Yap Cooperative Association (YCA) in 2007 for approximately \$4,000 could not be located.

Cause: Due to the nature of the project and the type of equipment acquired, computers were treated as consumable expenses, which likely led management to exercise less control over these assets.

Effect: A lack of accountability for and control over property and equipment could lead to their theft or conversion to personal use.

Recommendation: To ensure proper custody and control over property and equipment, as soon as possible perform a physical inventory of all computers in R&D. Additionally, establish and maintain adequate records of the cost, description, location, serial number, and date of purchase of property and equipment. Such records are desirable in order to provide:

- Historical information which would be valuable when selling or retiring the asset, purchasing similar items, or furnishing proof of loss for insurance purposes.
- A basis for physical inventory of property and equipment that would disclose theft or other losses.

Management should also implement the following:

- Attempt to track down the location of unaccounted for assets by comparing their serial numbers.
- Schedule periodic physical inventories and reconciliation with accounting records of property and equipment.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 3 –Unauthorized Appropriation and Obligation of Funds

Criteria: Article IX, Section 6, of the State Constitution prohibits the withdrawal of money from the state treasury or the obligation of funds except in accordance with law and the Yap State Code, under Title 13, further provides that expenses can be made only through the obligation of appropriated sums. Additionally, Part 1, Section 106, of the Financial Management Regulations prohibits authorizing an expense or obligation in excess of the sum made available by law. Moreover, the financial procedures of the Letter of Agreement establishing the Project in Yap provide a separate independent account for Project funds be maintained in accordance with the usual accounting procedures, laws, and regulations of Yap State Government.

Condition: The payment of Project expenses improperly and unlawfully used state funds. The Project was initially funded through the South Pacific Regional Environmental Program (SPREP) with a grant to the Federated States of Micronesia (FSM). Subsequently, execution in 2003 of the Letter of Agreement by and between Yap and the national government provided for the draw-down of funding by Yap such that grant funds would be passed through FSM which would in turn transfer the funds to Yap. Notwithstanding no funds were received by Yap from 2002 thru 2006, the Project incurred expenses for goods and services during that period. Payment of these expenses was through the use of Yap state funds, which had not been appropriated, either directly for the Project or to the Department of Resources and Development (R&D) on behalf of the Project. The Yap R&D was responsible for technical implementation of the Project.

Cause: The transfer of funds was not executed in accordance to the Letter of Agreement and grant funds were not available to meet Project expenses. Accordingly, management felt compelled to meet Project obligations through the use of state funds, though not authorized to do so.

Effect: State funds were obligated and disbursed contrary to public law and in violation of both the Yap State constitution and financial regulations. In the absence and full knowledge of grant funding and appropriations, the Project incurred obligations and expended funds, effectively creating an appropriation and allotting funds without the authority to do so.

Recommendation: Reemphasize to personnel the importance of complying with state laws and financial regulations and the significance the unauthorized use of state funds.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

**DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT**

International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 4 – Lack of Timely Drawn Down of Funding

Criteria: Annex III “Financial Procedures” of the Letter of Agreement stipulates that R&D establish a separate and independent account requiring dual signatures and relay the details of that account to the FSM Department of Finance and Administration (DFA). It also provides that, upon the receipt of funds from SPREP, FSM immediately transmit and transfer to the designated Project account the funds to Yap.

Condition: Unused grant and/or allotted funds due the Project remain uncollected. The Project did not receive any transfers of funds from the national government as required from the date of the Letter of Agreement to the end of 2006, but funding has subsequently provided through an national government allotment. Although there was an actual receipt of funds in 2007 in connection with the allotment, presently, \$37,276 of the allotment amount is yet to be received from the national government.

Cause: A timely request to the FSM national government for a cash drawdown of grant funding to cover expenses incurred and settled since 2003 was not made. Reimbursement was only requested in May of 2007, but after termination of the program. Moreover, there does not appear to have been any serious effort by R&D to ensure procedures for the transfer of funds were executed in accordance to the Letter of Agreement.

Effect: Non-compliance with the Letter of Agreement with respect to the request for draw-downs left the Project without adequate resources to fund expenses. Accordingly, management was compelled to turn to the use of state resources in violation of law to fund current operations of the Project.

Recommendation: A serious effort should be made by management to recover all funds, from whatever source, properly due the project. To ensure all funds due the Project have been received in conformity with the provisions of the Letter of Agreement and all funds have been properly accounted for:

- Contact FSM DFA and request immediate transfer to Yap of the uncollected portion of the allotment.
- Prepare an accounting from inception to calendar year end 2006 of all receipts and disbursements.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

- Request confirmation of the results of the above accounting with FSM DFA and SPREP.

Prior Year Status: This condition was reported in the prior year (2005) audit report.

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 5 – Competitive Bidding

Criteria: The financial procedures of the Letter of Agreement provides that a separate account, which is required to be established for Project funds, be maintained in accordance with the usual accounting procedures, laws, and regulations of Yap State Government. All purchases are by law subject to competitive bidding. Yap State Law No. 6-53 requires, for non-construction procurement, price comparisons of at least three vendors.

Condition: During our review of 2006 expenses, we noted no evidence of the performance of competitive bid procedures, as required by law.

Cause: Management failed to establish formal procurement policies and systematic processes that could have assisted in implementing competitive bid requirements in accordance with sound business practices and adherence to public law.

Effect: Competitive bidding of purchases helps ensure cost effective procurement of goods and services by, among other things, providing an incentive for suppliers to offer the best possible price, quality, terms, and service.

Recommendation: To ensure adherence to public law and conformity with sound business practice, establish formal procurement policies and procedures and communicate these to all staff. Written proposals received from vendors and suppliers should be maintained on file and information for oral bids recorded, including amounts and dates obtained.

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 6 – Budget Carryover

Criteria: The IWP Grant is a multi-year grant; therefore, the excess of budgets over expenses from the prior fiscal years should carry-forward as the opening budgets in each new fiscal period. It is the responsibility of the Project Coordinator to ensure that budgets are accurately reflected in the financial records.

Condition: Our review of financial reports produced by OAS continued to show discrepancies in unexpended budget figures. This is due to the failure to carryover budget amounts from prior year encumbrances.

Cause: Reconciliation of budgets was not done in an accurate or timely manner. There also seems to have been a routine neglect of standard procedures, which is reflected in the fact that for line items in which no budget figures had been entered, obligations were still being incurred and expenses settled.

Effect: Budgets were not rolled over into the next period accurately or in a timely manner. The IWP grant remaining budgets may not be accurately reflected in the Fundware financial management system as of December 31, 2006.

Recommendation: Budget reconciliations should be done in a timely manner. Also, obligations and expenses of State funds should not be made unless funds are available.

Prior Year Status: This is a prior year concern from 2005.

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.

DEPARTMENT OF RESOURCES AND DEVELOPMENT
YAP STATE GOVERNMENT
International Waters Project – Account No. A14-30-G0503
Schedule of Findings and Responses

Finding No. 7 – Contract Management

Criteria: Personal service contracts provide for the performance of certain services in return for the payment of a sum certain. As such, it is a legal agreement which creates certain rights and obligations between the parties. In executing the contracts, the Project incurred an obligation to pay for the services in advance, but also has a duty to ensure the services are performed in accordance with the contract terms and purposes.

Condition: We noted a lack of management supervision and review of contracted consultants. The Project engaged two local individuals in 2006 as consultants to help educate local communities on the objectives of the project and to assist in carrying them out. The agreements did not specify a time period for performance of the services, but provided for a one-time payment of \$4,500 for each person. Although each contract stipulated an expected outcome in terms of raising community awareness and impacting directly community outlook on the management and conservation of marine resources, there is no evidence this was ever measured. Moreover, we could find no reports which described to any great extent what activities were undertaken by the two consultants or what they actually accomplished. There is no evidence that the individuals even carried out the work they were contracted to perform.

Cause: The contract did not provide and management did not establish any criteria for evaluating the effectiveness of the work performed by the consultants.

Effect: The lack of proper supervision and review over managing the work of the consultants resulted in the failure to adequately assess what they were doing and determine whether that work was achieving the intended results.

Recommendation: Reemphasize to personnel the significance of close and timely supervision of contracted individuals and the significance of the failure to properly manage these contract.

Management Response and Corrective Action Plan: Management believes it is in no position to answer questions dealing with a certain period of time that took place long before those individuals assumed their respective offices.