

**Southern Yap 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

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## EXECUTIVE SUMMARY

### Financial Audit of the Southern Yap Water Authority for the Year ended September 30, 2005

The Office of the Yap State Public Auditor has released the final financial audit report of the Southern Yap Water Authority (SYWA) for the year ended September 30, 2005 which report is dated May 1, 2006. This is the first audit ever conducted for the Southern Yap Water Authority. 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 expressed no opinion.

The report on internal control over financial reporting and compliance and other matters required by *Government Auditing Standards* on page 10 discusses reportable conditions at the SYWA. These conditions and our recommendations are presented for the information of SYWA management in the Schedule of Findings beginning on page 12. Of the nineteen findings, three are considered to be material weaknesses. Fifteen findings are related to inadequate controls over financial reporting while four are related to noncompliance with laws and regulations.

The nineteen findings for the Southern Yap Water Authority represent classic examples of why "transparency", "accountability" and "ethics" are so important to good governance. Even though we have heard many political candidates offer different variations of the definitions of the words over the radio during the past month, in the context of our audits, we define them as follows:


- (1) Transparency – management must conduct its affairs in a way that it is never afraid to reveal its activities to the public because it has nothing to hide. Therefore, records must be available to allow independent review of management's activities.
- (2) Accountability – every action has a consequence – good or bad. Management has a responsibility to hold individuals within the entity accountable for their actions; to recognize and reward good performance and to deter or rectify poor performance. To quote an instructor in one of the courses we took on procurement fraud, "*Without discipline, there could be no accountability*".
- (3) Ethics – management must have the correct sense of what the public perceives as "right" or "wrong". Moreover, management must strive to do what is "right" in order to preserve the public confidence in government. This becomes the set of values which motivates decisions management make as public servants. A good sense of ethics in management will result in transparency and good performance in the public entity.

Having said the above, the following is a summary of the findings for SYWA:

- (1) Finding No. 1 – The current board composition is not consistent with the representation of the municipalities served by the water system called for in the enabling legislation.

- (2) Finding No. 2 – Not all minutes of board meetings were transcribed and filed at the SYWA office for easy reference.
- (3) Finding No. 3 – SYWA's enabling law set its bidding threshold at \$2,500. SYWA waived bidding requirement for a \$4,950 contract as if its bidding threshold was \$10,000.
- (4) Finding No. 4 – The contract in Finding No. 3 above was signed by SYWA and a company owned by a close relative of one of the board members. The actual work was performed and payment received by the board member who signed the contract on behalf of SYWA.
- (5) Finding No. 5 – We were provided copies of minutes for only four board meetings. None of the minutes reflected the board decision to award the contract in Finding No. 3 to the contractor selected.
- (6) Finding No. 6 – We feel that the Governor's representative on the Board should have done more to ensure SYWA's compliance with State laws and regulations.
- (7) Finding No. 7 – A computer and printer were claimed under a FEMA grant, but we only found a used computer donated by PW&T at SYWA. The request for the State Legislature grant received by SYWA in FY06 included another two computers. There are only two employees at SYWA.
- (8) Finding No. 8 – With regards to the FEMA grant used to fund the contract discussed in Finding No. 3, SYWA breached most of the applicable provisions of financial management laws and regulations relating to the selection of contractor, performance of the work, and payment of the contract. In addition, there was a lack of proper accounting for the grant.
- (9) Finding No. 9 – The previous board of SYWA became inactive to the point that the SYWA operated without a general manager for almost two years during which time the Authority ceased billing customers.
- (10) Finding No. 10 – A clerk hired in FY05 wrote seven SYWA checks worth \$1,302.70 to herself. In addition, \$105.20 in cash receipted was never deposited to the bank. The clerk is a close relative of one of the board members.
- (11) Finding No. 11 – Board members bought two water pumps in April 2005 using \$1,956 cash withdrawn from the savings account. An official check was not written to document the purchase.
- (12) Findings No. 12 through 19 relates to inadequate accounting and financial records for the Authority during fiscal year 2005.

The Board of Directors has reviewed our report and has disagreed with some of the findings contained therein. The board's written response is presented on page 28 followed by comments from the Public Auditor on page 35.

  
Gertrude Gootinan  
Yap State Public Auditor  
October 26, 2006

# SOUTHERN YAP WATER AUTHORITY

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Directors of  
Southern Yap Water Authority:

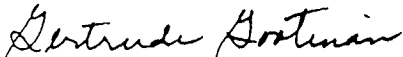
I was engaged to audit the accompanying balance sheet of the Southern Yap Water Authority (SYWA) as of September 30, 2005, and the related statement of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the SYWA's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

The SYWA 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 conforming 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 SYWA 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.

SYWA did not present Management's Discussion and Analysis that, although is not a required part of the basic financial statements, is supplementary information required by the Governmental Accounting Standards Board Statement No. 34.

In accordance with *Government Auditing Standards*, I have also issued a report dated May 1, 2006 on my consideration of the Southern Yap 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

May 1, 2006

**SOUTHERN YAP WATER AUTHORITY**

Balance Sheet  
September 30, 2005

| <b>ASSETS</b>                        | <b>2005</b>                   |
|--------------------------------------|-------------------------------|
| Current Assets                       |                               |
| Cash                                 | \$ 4,897                      |
| Other receivables                    | <u>2,779</u>                  |
| Total current assets                 | 7,676                         |
| Property and equipment               | <u>1,752</u>                  |
| <b>TOTAL ASSETS</b>                  | <b><u><u>\$ 9,428</u></u></b> |
| <b>LIABILITIES AND DEFICIT</b>       |                               |
| Current liabilities:                 |                               |
| Accounts payable                     | \$ 6,314                      |
| Other accounts payable (note 4)      | <u>3,636</u>                  |
| Total current liabilities            | 9,950                         |
| Contingencies                        |                               |
| Net Deficit                          |                               |
| Reserved for capital assets          | 1,752                         |
| Unreserved                           | <u>(2,274)</u>                |
|                                      | (522)                         |
| <b>TOTAL LIABILITIES AND DEFICIT</b> | <b><u><u>\$ 9,428</u></u></b> |

See accompanying notes to financial statements

**SOUTHERN YAP WATER AUTHORITY**

**Statement of Revenues, Expenses and Changes in Net Assets  
For the Year Ended September 30, 2005**

|                                 | <u>2005</u>     |
|---------------------------------|-----------------|
| Operating revenues              |                 |
| Water usage and other fees      | \$ 5,306        |
| Others                          | 903             |
|                                 | <hr/>           |
| Total operating revenues        | 6,209           |
| <br>                            |                 |
| Operating expenses              |                 |
| Utilities                       | 8,110           |
| Supplies & materials            | 5,620           |
| Salaries & wages                | 2,243           |
| Depreciation                    | 204             |
| Fuel and others                 | 143             |
| Payroll tax                     | 142             |
|                                 | <hr/>           |
| Total operating expenses        | 16,462          |
| <br>                            |                 |
| Loss from operations            | (10,253)        |
| <br>                            |                 |
| Nonoperating revenues           |                 |
| Interest income                 | 42              |
|                                 | <hr/>           |
| Total nonoperating revenues     | 42              |
| <br>                            |                 |
| Net loss                        | (10,211)        |
| <br>                            |                 |
| Net assets at beginning of year | 9,689           |
|                                 | <hr/>           |
| Deficit at end of year          | <u>\$ (522)</u> |

See accompanying notes to financial statements.

**SOUTHERN YAP WATER AUTHORITY**

Statement of Cash Flows  
For the Year Ended September 30, 2005

Increase (Decrease) in Cash

|   | <u>2005</u>              |
|---|--------------------------|
| Cash flows provided by (used for) operating activities                        |                          |
| Receipts from customers   | \$ 6,209                 |
| Payments for goods and services   | (7,941)                  |
| Cash payments to employees  | (2,243)                  |
| Net cash used for operating activities  | <u>(3,975)</u>           |
| Cash flows from (used for) investing activities                               |                          |
| Interest income   | 42                       |
| Acquisition of fixed assets   | (1,956)                  |
| Net cash used for investing activities  | <u>(1,914)</u>           |
| Net decrease in cash  | (5,889)                  |
| Cash, beginning of year   | <u>10,786</u>            |
| Cash, end of year   | \$ <u><u>4,897</u></u>   |
| Reconciliation of Operating Loss to Net Cash used<br>for Operating Activities |                          |
| Operating Loss:   | \$ (10,253)              |
| Adjustment to reconcile net loss to net cash used in operating activities     |                          |
| Depreciation  | <u>204</u>               |
| Decrease in assets  |                          |
| Other receivables   | (2,779)                  |
| Increase in liabilities   |                          |
| Accounts payable  | 8,853                    |
| Net cash used in operating activities   | \$ <u><u>(3,975)</u></u> |

See accompanying notes to financial statements



# SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements  
September 30, 2005

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Reporting Entity** - The Southern Yap Water Authority (SYWA) was created in 1986 pursuant to Yap State Law (YSL) No. 1-221 which is codified as Chapter 7 of Title 18 of the Yap State Code. The primary purpose of the SYWA is to "carry on the business of establishing, developing, maintaining, operating, and managing the Southern Yap Water System". The water system currently serves the southern communities of Yap Proper comprising the southernmost villages of the municipalities of Rull and Dalipebinaw and the municipalities of Gilman and Kanifay. The SYWA is a legally separate entity of the Yap State Government.

SYWA is governed by a six-member Board of Directors, two of which are appointed by the Rull Municipality representative on the Council of Pilung, one of who has to resident of the village of Luwech or Lamer. The Council of Pilung representatives for the municipalities of Dalipebinaw, Kanifay and Gilman appoint the next three members - one each from their respective municipalities. The sixth member is appointed by the Governor for a four year term. The chiefs' appointees serve three-year terms. The daily operation of the Authority is carried out by a general manager and a meter reader.

**Basis of Accounting** - SYWA 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. SYWA 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 SYWA to maintain them permanently.

# SOUTHERN YAP WATER AUTHORITY

## Notes To Financial Statements September 30, 2005

- (c) **Expendable** – Net assets whose use by the SYWA 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.
- (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 SYWA 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, SYWA 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, SYWA 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 deposit in a bank account. The cash balance for the year ended September 30, 2005 is fully collateralized as such is subject to Federal Deposit Insurance Corporation (FDIC) coverage.

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

## 2. RECEIVABLES:

Receivables at September 30, 2005 represent revenue from June, July, August, and September 2005 that was billed to customers and collected in February 2006. Prior to June 2005, SYWA had ceased to bill its customers on a regular basis. Upon resuming its billing and collection efforts in February 2006, the SYWA Board of Directors agreed not to pursue collection of unpaid and/or unbilled water usage for pre-June 2005 periods. Accordingly, receivables related to water usage before June 2005 is not considered in the accompanying financial statements.

# SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements  
September 30, 2005

Details of receivables are presented below:

|                                 | <u>2005</u>     |
|---------------------------------|-----------------|
| Trade receivables               | \$ 2,779        |
| Allowance for doubtful accounts | <u>    --</u>   |
|                                 | <u>\$ 2,779</u> |

### 3. PROPERTY & EQUIPMENT

Costs of the SYWA water distribution system of \$2.0 million is included in fixed asset of the Yap State Government for the year ended September 30, 2005 and therefore, such cost was not considered in SYWA's fixed assets at September 30, 2005. Assets shown at September 30, 2005 represent the cost of two water pumps of \$1,956 purchased in April 2005. The pumps have estimated useful lives of four years. Depreciation expense using the straight-line method is \$205 for the year ended September 30, 2005.

### 4. ACCOUNTS PAYABLE

Provided below is a summary of accounts payable at September 30, 2005:

|                        | <u>2005</u>     |
|------------------------|-----------------|
| Supplies and materials | \$ 5,719        |
| Electricity            | <u>    595</u>  |
|                        | <u>\$ 6,314</u> |

### 5. DUE TO THE STATE TREASURY

On September 8, 2005, the State assisted the SYWA settle outstanding FY04 and FY05 electric bills in the amount of \$3,636. In his memo to the State Finance requesting payment of the SYWA electric bills, the Lt. Governor stated, "It is the general understanding of all concerned that the Southern Yap Water Authority will reimburse (the State) when funds are available)...." Accordingly, the amount of the electric bills paid by the State Finance has been recorded as a payable to the State Treasury as of September 30, 2005.

### 6. RELATED PARTY TRANSACTIONS

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

# SOUTHERN YAP WATER AUTHORITY

Notes To Financial Statements  
September 30, 2005

## 7. RISK MANAGEMENT

SYWA 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 SYWA. Management is of the opinion that no material losses have been sustained as a result of this practice.

## 8. CONTINGENT LIABILITIES

Certain board members have submitted to the Authority \$2,181 and \$1,180 worth of claims for reimbursement of expenses that they allegedly incurred on behalf of the Authority for fiscal years 2005 and 2006, respectively. Whether the Authority will reimburse the claims are contingent on whether:

- (1) the claims are adequately supported by third party invoices and other documentation,
- (2) SYWA is the actual beneficiary of the expenses incurred, and
- (3) the Board as a whole approves the reimbursement requests.

Because the ultimate outcome of the matter is uncertain pending the Board's review of the transactions, no provision for the liability has been made in the accompanying financial statements.

## 9. SUBSEQUENT EVENTS

- A) **FY06 Operating Subsidy** – A Memorandum of Agreement (MOA) between the State of Yap as “Grantor” and Southern Yap Water Authority as “Grantee” was executed in March 2006 for \$78,700 appropriated by YSL 6-60 from the Yap State General Fund for the operation of the Authority. Per the terms of the MOA, \$59,025 will be advanced to SYWA in March 2006 and the remaining balance of \$19,675 in June 2006.
- B) **Missing Cash** – From December 2005 to March 2006, an employee of the Authority was involved in unauthorized activities that resulted in a known loss of \$1,407 in cash. The employee has since been terminated and the matter referred to the Office of the Attorney General. That office is currently working with the Board of Directors to effect collection of lost funds.
- C) **FEMA Grant** – SYWA is the beneficiary of two project worksheets (PW) approved by the U.S. Federal Emergency Management Agency (FEMA) for Public Assistance Grants awarded to Yap State in the aftermath of Typhoon Sudal which devastated Yap in April 2004. The scope of work involves repair of the roof of the pump-house and the office building and replacement of certain contents of the office building. The two PWs have a combined authorized budget of \$4,950. The contract for the work was awarded by the FEMA Yap field office to an immediate family member of one of the Board members in April 2006, but a different board member performed the actual work.

**SOUTHERN YAP WATER AUTHORITY**

Notes To Financial Statements  
September 30, 2005

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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  
Southern Yap Water Authority:

I was engaged to audit the financial statements of Southern Yap Water Authority (SYWA) as of September 30, 2005, and for the year then ended, and have issued my report thereon dated May 1, 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 SYWA'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. I noted certain reportable conditions involving the internal control over financial reporting that I have reported to management in the accompanying Schedule of Findings as Findings Nos. 5 thru 19. Of these findings, I consider Findings No. 12 thru 14 to be material weaknesses.

**Compliance**

As part of obtaining reasonable assurance about whether SYWA'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 thru 4.

This report is intended for the information of the management and Board of Directors of the Southern Yap 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

May 1, 2006

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## **FINDING NO. 1 - COMPOSITION OF THE BOARD**

**Criteria:** YSL No. 2-36 states, "members of the SYWA Board shall comprise of six (6) members – one appointed by the Governor, two (2) appointed by the Rull municipal chief, which one shall be from Luwech or Lamer, and the remaining three (3) shall be appointed each by the municipal chiefs of Gilman, Kanifay and Dalipebinaw".

**Condition:** In 2005, seven (7) Board members were appointed of which, one (1) is the Governor's representative, one (1) from Luwech, one (1) from Lamer, two (2) from Gilman and two (2) from Kanifay. Dalipebinaw did not appoint anyone to be on the Board.

**Cause:** The newly appointed Board of Directors sought legal advice on the composition of the Board and was told to maintain the status quo while working with the chiefs to request the Yap State Legislature to amend the section in the enabling legislation relating to the composition of the Board.

**Effect:** Current composition of the Board of SYWA is inconsistent with the requirements of the SYWA enabling legislation and we have not yet seen any official communication to the chiefs to begin the process of amending the law relating to SYWA Board membership.

**Recommendation:** We recommend that the newly established Board of Directors for SYWA should discuss with the chiefs of the four municipalities of Rull, Kanifay, Gilman and Dalipebinaw, the appropriate number of members for the governing body of the Authority. If it is deemed necessary to increase the number of members, a request should be sent to the Governor and Legislature to amend the above law.

## **FINDING NO. 2 BOARD MEETING MINUTES**

**Criteria:** Minutes should be prepared on a timely manner in order for the Board to review and adopt in the next meeting. In addition, adopted minutes should be kept on file at the Authority.

**Condition:** Minutes for SYWA Board held during fiscal year 2005 and up to May 2006 had not been transcribed by the Secretary of the Board.

**Cause:** The Board did not require that draft minutes of meetings be available for review by the Board at subsequent meetings.

**Effect:** An official record of the proceedings of the Board of Directors for the Southern Yap Water Authority during fiscal year 2005 and 2006 was not available.

**Recommendation:** We recommend the Chairman to ensure that all Board meeting minutes be prepared, reviewed, signed and be kept on file at SYWA to reflect the Board's decisions and actions taken for the operation of the Authority.



# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## FINDING NO. 3 – COMPETITIVE PROCUREMENT

**Criteria:** The enabling legislation of SYWA, Section 748 of Title 18 of the Yap State Code stated, "Purchases of all supplies and materials and the construction of all works, when the expenditures exceed \$2,500, shall be by contract let to the lowest responsible bidder in compliance with procedures of the State Contracts Act. Notice requesting bids shall be published at least ten (10) days before bids are received".

**Condition:** A contract was awarded to a local contractor for the renovation of the SYWA office building and the replacement of the building contents. In April 2006, Yap State under FEMA Fund, paid \$4,950 to the contractor. We found no evidence of efforts to competitively procure the contract. The contractor is an immediate family member of one of the members of the Board.

A section in the contract agreement between SYWA and the contractor attempted to justify that competitive procurement was not required because such construction contract was below \$10,000 and purchase of materials involved was less than \$5,000. However, a contractual provision such as the one inserted by SYWA cannot take precedence over the provisions of the law that created the SYWA.

**Cause:** There was no attempt to competitively procure the work. A designation letter signed by one of the Chiefs and a Board member clearly stated they have "discussed and agreed upon the JG Construction to be fully responsible of the renovation work of SYWA office building".

Because a decision was made at the outset to forgo competitive procurement, SYWA Board did not consider their responsibilities with regards to formal bidding laws. Instead, the Board used the State bidding threshold to justify the lack of competitive procurement. Unfortunately, that threshold was higher than the threshold specified in the SYWA enabling legislation.

**Effect:** SYWA let out a contract to one of its board members in contradiction to SYWS enabling legislation that required SYWA to formally bid all contracts exceeding \$2,500.

**Recommendation:** We strongly recommend that the Board and management should review the enabling legislation set forth in the Yap State Code which created SYWA, to better understand their responsibilities, duties and requirements involving the operation of the Authority to prevent future noncompliance with the laws and regulations of the State of Yap.

## FINDING NO. 4 – CONFLICTS OF INTEREST

**Criteria:** Contracts are legally binding documents which terms are enforceable by law. Therefore, intentional misrepresentation of facts by the parties named on the contract may constitute fraud.

**Condition:** The Southern Yap Water System was awarded \$4,915 under the FEMA Public Assistance Grants for Typhoon Sudal comprising \$2,914 for the repair of its pump house and \$2,037 for the replacement of 490 sq. ft. of roofing on the office building and replacement of a typewriter, copier and half of the cost of a refrigerator.

## SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

### Finding No. 4 (cont.)

The contract was awarded to an immediate family member of a board member but the actual work was performed by a different construction company owned by another board member. The construction payment was made payable to the company named on the contract, but the board member who performed the work was the one who attempted to provide us invoices to support the costs claimed for the project.

**Cause:** The Board member who performed the repair work on the office was the one who was directly involved in preparation of the paperwork necessary to secure the grant. He may have recognized the obvious conflicts of interest if he were to award the contract to himself, therefore, he arranged to have the contract awarded in name only to a relative of another board member.

**Effect:** The funds for the two FEMA project worksheets were combined to increase the scope of work for the repair of the office building with the justification that future funding would be secured for the repair of the pump house. In FY06, SYWA was awarded a grant from the General Fund of over \$78,000. The repair of the pump house was not included in the budget. In addition, the office equipment included in the office building project worksheets had not been purchased even though 100% of the funding was paid to the contractor. Moreover, the board member who performed the work could not provide valid invoices to support the costs he claimed for the contract.

**Recommendation:** We recommend that Board of Directors formally adopt a policy to prohibit members of the Board of Directors, employees, and their immediate family members from participating in SYWA contracts as stipulated by State and Federal laws.

### FINDING NO. 5 - BOARD'S DECISION

**Criteria:** The corporate powers of a Board of Directors are vested in the board as a whole and not on board members as individuals. Therefore, only decisions made by a majority vote of a quorum of the Board during an official board meeting are legally binding on the Authority.

**Condition:** SYWA was unable to provide all the minutes prepared during the Board's meetings to enable us to determine whether major activities of the SYWA were properly reviewed and approved by a majority vote of the board.

We have been provided only four board meeting minutes dated May 10 and May 23, 2005, June 13, 2005 and April 3, 2006. None of the four minutes reflected the board's decision to award the construction contract for the office renovation which is the subject of Finding No. 2.

**Cause:** A designation letter signed by a Council of Pilung member and a board member of SYWA to the Public Assistance Office, explained that per their discussions they had chosen the contractor for the renovation work of SYWA office building. Since no other evidence was presented, such decision appeared to have been made by one or two members of the Board of Directors.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 5 (cont.)

**Effect:** Chiefs of the four municipalities of Rull, Kanifay, Gilman and Dalipebinaw are not authorized by Yap State Law to act on behalf of the SYWA Board unless appointed to serve on the Board. In addition, allowing decisions to be made by one or two members of the Board of Directors increases the risk of abuse of power by members of the SYWA Board.

**Recommendation:** We strongly recommend that board document its official decisions in certified board resolutions. In addition, meeting minutes should be prepared to document that major decisions were made by a quorum of the board as required by law. This would provide assurance that board decisions are made within the sphere of the SYWA board's corporate powers.

## FINDING NO. 6 – GOVERNOR'S APPOINTEE TO THE BOARD

**Criteria:** The government representative on the Board of Directors is responsible to ensure that the SYWA conducts its affairs in compliance with applicable laws and regulations.

**Condition:** The government representative on the SYWA Board of Directors is an employee of the Contracts Division of the Department of Public Works and Transportation and should be well informed of the procurement requirements of the State of Yap. Yet, with regards to the FEMA Project Worksheets for Typhoon Sudal, we found that SYWA did not comply with its bidding threshold of \$2,500 and did not abide by the State Ethics Act and U.S. procurement standards that require officers and employees to avoid conflicts of interest.

**Cause:** The government representative did not assist the SYWA to ensure compliance with the State Ethics Act and U.S. Federal requirements and SYWA's enabling legislation.

**Effect:** The participation of the Board members in the contract for the repair work of the office building hindered the ability of the whole board to ensure that the work was carried out in the best interest of the SYWA and in compliance with laws and regulations.

**Recommendation:** We recommend that the Governor review the track record of the government representative on the Board of SYWA and make replacement as necessary to ensure that the incumbent fulfills his responsibility. We also recommend that the Chairman of the Board ensure that future contracts or purchase orders meeting or exceeding the bid threshold of \$2,500 be reviewed by a quorum of the board. The selection of the contractor or supplier shall be documented in the meeting minutes. Moreover, the Board members, employees and their immediate family members should be prohibited from participating in SYWA contracts.

## FINDING NO. 7 – REVIEW OF FUNDING REQUESTS

**Criteria:** Procedures and policies should be in place to provide assurance that SYWS funds are only expended in furtherance of the goals and business objectives of the Authority and to mitigate the risks of fraud, waste and abuse.

## SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

### Finding No. 7 (cont.)

**Condition:** Our review of events subsequent to September 30, 2005 found that SYWA claimed from FEMA (Federal Grants) one computer and printer with a combined worth of \$625 and during the same period budgeted \$4,000 for two computers and printer sets to its State of Yap funding. SYWA currently has only two employees, the operation manager and the meter reader. We believe that one computer can easily meet the current needs of the office staff.

**Cause:** Generally, preparation of budgets and grant funding requests is the responsibility of the General Manager with review and approval by the Board of Directors. However, during the period of the above requests, the general manager position was vacant, therefore, the managerial functions was carried out by a board member without adequate review and input from other board members.

**Effect:** We have no reliable evidence that funds claimed from FEMA was actually used to purchase a replacement computer. The only computer found at the office was a used computer donated by the Contracts Division of the Dept. of Public Works and Transportation. We have confirmed with an employee of the Contracts Division that the office actually donated a used computer to SYWA.

**Recommendation:** We recommend that the Board of Directors delegate the responsibility of budget preparations and funding requests to the Operations Manager as the tasks are the responsibilities of a general manager. Whether managerial tasks are carried out by the GM or a board member, the board as a whole should review and approve the budget before submission or adoption. Again, board approval should be sought during an official meeting of the board and the final decision should be documented in Board minutes.

### FINDING NO. 8 – LACK OF ACCOUNTABILITY OVER GRANT FUNDS

**Criteria:** In order for costs to be allowable under U.S. Federal grants, such costs should be supported by underlying documentation sufficient to establish the reasonableness and necessity of the costs claimed.

**Condition:** On April 20, 2006, a FEMA Grant of \$4,950 was disbursed to a local contractor who is an immediate family member of a Board member for the renovation of SYWA office building. Our review of the check found that it was endorsed by the contractor to a member of the Board who (according to other board members) actually carried out the work called for under the FEMA project worksheets for Typhoon Sudal.

Documentation available to support the check paid to payee was a contract between SYWA and the payee which provisions were clearly inconsistent with actual events as we understood them:

- (1) The contractor named on the contract agreement and the check (the official contractor) did not perform the work. Instead, we were told that the work was performed by a company owned by a board member, even though the contract had a clause prohibiting the contractor from assigning the work or part of the work to someone else.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 8 (cont.)

- (2) The scope of work on the contract called for minor repairs on the office building and repair of the roof for the transmission and distribution building (pump house). We observed during our visits to SYWA that only the office building was repaired. The pump house's roof (which had been the subject of the FEMA project worksheet) had not been repaired.
- (3) The term of the contract was for 120 calendar days beginning on February 1, 2006 through June 2, 2006, with payment to occur after successful completion of the project. The last approving signature on the contract was dated April 12, 2006. The check payment was issued 8 days later on the 20<sup>th</sup> of April.
- (4) Suspecting that the contract was drawn up just to allow the State Finance to process payment to the contractor, we asked SYWA to submit invoices to support the claim for the FEMA Grant. Several invoices and receipts aggregating \$5,080 were submitted to our office to supposedly substantiate the claim against the FEMA Grant through the Yap State Government.

We found \$4,530 worth of the invoices to be questionable. Two were charge invoices without proof of payments and one was from a sales book that one local vendor uses as its proforma invoice. A computer specified in the claim was nowhere to be found at the SYWA office. A board member offered that the computer was at his residence. The invoices submitted were dated in December 2005 and January 2006.

Cause: The SYWA Board explained the above discrepancies by stating that their first priority when they took over management of SYWA in June 2005 was to repair the office building to allow SYWA to resume normal operations. Accordingly, a member assigned his own company to repair the office building, using his own materials, then began the process to seek reimbursement.

- (1) Discussions with the FEMA representatives revealed that the board member could not be directly reimbursed for his costs due to obvious conflicts of interest. With no other choice, SYWA had to name a different contractor on the contract and the official contractor (also a related party) was therefore named as the contractor. On October 13, 2005, a letter was written to the FEMA field office signed by the board member who performed the work and the Chief of Kanifay designating the official contractor to perform the work on the FEMA PWs for the SYWA.
- (2) The board member who performed the work sent a letter dated August 4, 2005 to the FEMA field office asking for permission to combine the funding of the two FEMA PWs to allow an increased scope of work for the office building. The letter stated that the pump house would be repaired at a later time when other funds become available. The request was obviously ignored in the contract that was drawn up in January 2006 between the official contractor and SYWA. The contract called for a scope of work that was as written on the FEMA project worksheets.

## SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

### Finding No. 8 (cont.)

- (3) On April 12, 2005 when Finance certified funds availability for the contract, the work was already considered complete. The Final Inspection Report from Planning and Budget, dated April 6, 2006, stated, *'It is evident that the contractor and (sic) had completed the work on this project based on FEMA Scope of work indicated on the project worksheet'*. We do not know how the OPB inspector could make the above comment when the roof of the pump house was not repaired.
- (4) Despite the intent to seek reimbursement for the costs of the repairs done on the office building, the SYWA did not make an effort to obtain valid and authoritative proof of the costs incurred for the repairs. Whether this was based on advice from the FEMA office who may have told SYWA that only a contract was necessary to claim the FEMA funds, is not known. At any rate, the invoices we were provided were not sufficient proof of the costs incurred.

**Effect:** The inconsistencies and discrepancies discussed above showed very poor accountability over the FEMA Grant of only \$4,950. SYWA received over \$78,000 in FY06. Unless the Board of Directors learns from mistakes made in the administration of the FEMA Grant, and ensure proper accountability of the State Grant, the Authority would not be able to provide proper and reliable accounting of the current grant to the State Legislature.

**Recommendation:** To properly fulfill their responsibility to safeguard State and Federal funding entrusted to their care, we recommend that the Board of Directors immediately take the following actions:

- (1) Adopt a policy to prohibit companies in which employees or board members have financial interests from participating in contracts let by SYWA.
- (2) Require that the board as a whole approve in advance payments from personal funds made by a board member or employee on behalf of SYWS. If a situation should arise in which personal funds are needed to supplement the financial operations of the Authority, the transaction should be transacted as a loan describing the full scope of the transaction and explaining the terms and conditions in writing.
- (3) Adopt a policy to accept nothing less than veritable proof of payments when board members and employees submit claims for reimbursement against the Authority.
- (4) Ensure that procurements abide by the threshold for competitive bidding called for by SYWA's enabling legislation of \$2,500.

### FINDING NO. 9 - OPERATING WITHOUT A MANAGER

**Criteria:** Yap State Code, Title 18 Section 744 that created SYWA, requires the Board to appoint a Manager and an Assistant Manager to work at the discretion and pleasure of the Board to perform the following duties:

- ◆ To ensure that all rules and regulations of SYWA are enforced.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 9 (cont.)

- ◆ To keep the Board advised on the needs and status of the Authority.
- ◆ To approve demands for payment of obligations within the purposes and amounts authorized by the Board.
- ◆ To prepare all plans and specifications for the operation and maintenance of facilities operated by the Authority.
- ◆ To devote his entire time to the business of the Authority.
- ◆ To cause to be published within sixty (60) days after the end of each fiscal year a financial status of the Authority.
- ◆ To perform such other and additional duties as the Board may require.

**Condition:** The former Manager of SYWA resigned early in fiscal year 2004 leaving behind the sole meter reader who became responsible for the daily operation of the Authority, including the handling of cash. It was not until December 2005, when a new manager was hired.

**Cause:** The old Board members of SYWA knew that a general manager was required by law to run the operation of the Authority, but did not immediately fill the vacancy. In addition, the old Board was partially inactive due to the loss of its chairman and the lack of participation of the other 2 members including the Governor's appointee.

**Effect:** Due to the lack of management to ensure that the Authority was functional, SYWA, for a period of almost two years did not collect any revenue.

**Recommendation:** Although the new SYWA Board has recruited a general manager, we recommend that the Board develop policies and procedures to ensure the active participation of all its members and to provide for the immediate recruitment of key management staff.

## FINDING NO. 10 – MISSING CASH

**Criteria:** SYWA should be accountable for all its cash transactions.

**Condition:** In our attempt to compile the SYWA financial statements for fiscal year 2005, we compiled a listing of checks from check copies issued during fiscal year 2005 and compared the list to checks clearing the bank statements. We also reviewed checks issued after September 30, 2005 in order to identify invoices for fiscal year 2005 paid in fiscal year 2006.

Our review of checks into fiscal year 2006 found seven unusual checks aggregating \$1,302.70 which cleared the bank from January through March 2006. First, the checks were outside the range of checks written by SYWA from October 2004 to May 2006 of 4223 through 4227. Second, the checks were made payable to three or four variations of the office clerk's name. Third, the approving signatures on the checks did not resemble any of the board members' signatures. The checks had been cashed at local establishments. Because of the irregular details of the checks, we suspected that the checks had been forged. The check number, dates and amounts are listed below:

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 10 (cont.)

|          |      |                   |
|----------|------|-------------------|
| 12/22/05 | 4593 | \$152.20          |
| 01/30/06 | 4591 | 300.00            |
| 2/15/06  | 4584 | 150.50            |
| 3/28/06  | 4581 | 200.00            |
| 3/30/06  | 4578 | 175.00            |
| 3/30/06  | 4577 | 150.00            |
| 3/27/06  | 4579 | <u>175.00</u>     |
| Total    |      | <u>\$1,302.70</u> |

Our queries to the General Manager and a couple of board members found that management was aware of the unauthorized checks and that fact had been the cause for the clerk's termination. We learned that the office clerk had obtained several pages of blank checks from the SYWA checkbook allowing her to write the unauthorized checks. The actual number of missing checks was not known because the checkbook had been in use for several years and the new board members did not know the last check number in the check stock.

In addition to the unauthorized payments above, the general manager also found that \$105.20 in cash received during the above period was never deposited to the bank.

**Cause:** Due to the small number of employees, there was no adequate segregation of duties. The office clerk was responsible for receiving payments, issuing cash receipts and banking collections. She also had access to the blank check stock and was responsible for preparing check payments for management's signature. Moreover, we found no evidence that management attempted to hire the best available person for the position of office clerk by advertising the vacancy. Instead, a relative was recruited who was obviously not the best candidate for the position.

**Effect:** SYWA lost a total of \$1,407.90. This was the only amount of cash that management had acknowledged was missing. It is highly likely that the clerk also received cash payments from customers without issuing receipts, thus leaving no record of the cash having been in her custody.

**Recommendation:** We recommend that the Board of Directors review the duties and responsibilities of the three full-time employees to allow for adequate segregation of duties. Moreover, management should make the effort to hire the best person for its vacancies. Position descriptions and duties and responsibilities of vacancies, along with minimum qualification requirements should be advertised publicly for at least 30 days. Applications received should be reviewed with the aim of finding the best-qualified person for the job.

Management has the responsibility to deter fraud, waste and abuse. In that regard, we recommend that the Board of Directors formulate policies and procedures for the Authority to reduce the risk of fraud and to ensure that fraud or errors can be timely detected by employees in the normal course of performing their assigned functions.



# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## FINDING NO. 11 – PAYMENT MADE IN CASH

**Criteria:** To maintain proper accountability over cash and to ensure complete and accurate recording of expenses, disbursement of company funds should be documented through issuance of check payments.

**Condition:** Our review of the saving and checking account activities for SYWA found that from October 2004 to the beginning of April 2005, every withdrawal made from the savings account was traceable to a deposit to the checking account in the same amount. But on April 21, 2005 a withdrawal of \$1,956 was made from the savings account without a corresponding deposit to the checking account.

**Cause:** Management did not ensure that appropriate documentation was maintained for expenditures. We found that the Board members used the amount withdrawn on April 21, 2005 to pay for two new pumps for the Authority. April 2005 was the approximate time that the SYWA lost one of its two pumps at the old airport wells. An employee of the YSPSC water division was asked to order a water well pump for the Authority. The employee told us that the pump cost \$1,948.50 and that the SYWA gave him the amount in the form of a money order. The difference between this amount and the amount of the unrecorded withdrawal is \$7.50 which is the same amount as the fee for a postal money order.

**Effect:** Other than what the YSPSC employee told us about the cost of the pumps, SYWA was unable to provide documentation to substantiate the cost of the pumps and to verify that the cash withdrawn was appropriately expended. In addition, if SYWA had used other cash, say, from collections to settle other official expenses, records of such receipts and expenditures were unavailable.

**Recommendation:** We recommend that the Board of Directors require that all cash collected by the Authority should be receipted and banked to the savings account. At no time should collections be used to pay for expenses. Moreover, payment of expenses should only be effected through Authority checks. The practice of using cash to settle liabilities should be immediately stopped as that leaves behind no reliable records of expenditures of Authority funds.

We also recommend that the Board of Directors instruct the bank in writing to honor cash withdrawals **only if** the withdrawal is needed to effect a cash transfer between SYWA accounts. This will mitigate the risk of someone obtaining cash for unauthorized purposes.

## FINDING NO. 12 – LACK OF AN ACCOUNTING SYSTEM

**Criteria:** SYWA 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):

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 12 (cont.)

- (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.
- (2) *GAAP requires the use of a general ledger, a set of accounts utilized to keep track of five essential categories of accounting data:*
  - (a) Assets – cash, receivables, inventory, property and equipment;
  - (b) Liabilities – accounts payable to suppliers and vendors, salaries payable, taxes payable;
  - (c) Net assets – Fund balance comprising the cumulative differences between revenue and expenses since inception of the Authority;
  - (d) Revenues – customer billings, grants received, and other income and;
  - (e) Expenses – salaries and wages, utility expense, fuel, supplies and material, etc.
- (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 as opposed to the cash basis which records revenues and expenses only at the time that cash is received or paid out.
- (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, SYWA was not able to comply with this basic accounting principle.
- (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. SYWA did not have a chart of accounts in place during fiscal year 2005.

**Condition:** SYWA had no accounting system in place that would allow for the preparation of internal or external accounting and financial reports.

**Cause:** There is no trained accountant at SYWA to set-up and maintain a reliable accounting system from which financial statements could be prepared.

**Effect:** SYWA had no records of its financial activities during fiscal year 2005. Consequently, we had to compile SYWA's financial statements ourselves using information obtained from banks, vendors, and SYWA collection and whatever documents we were able to find in the office. Because we had prepared the financial statements ourselves, auditing standards prevented us from issuing an opinion on the audit for SYWA as we could not audit our own work.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 12 (cont.)

**Recommendation:** We recommend the Board of SYWA immediately take appropriate action to purchase a simple accounting program such as *Quickbooks Pro* and hire someone to set up the program by creating a chart of accounts, establish beginning balances, and train the accounting clerk to post transactions.

## FINDING NO. 13 – ACCOUNTING POLICIES AND PROCEDURES

**Criteria:** Accounting policies and procedures should be in place to ensure accurate and reliable financial information.

**Condition:** SYWA did not have any accounting policies and procedures in place during fiscal year 2005. We found that even a simple check register, listing the details of checks written during the fiscal period was not maintained. Moreover, SYWA issued cash to settle expenses leaving no paper trail for accounting purposes. Our review of bank statements during fiscal year 2005 found cash deposits to the checking and savings accounts, but no receipts were found in the office that could provide details on the collections received and deposited by the Authority. At the time of our fieldwork in fiscal year 2006, we found that the Authority had begun issuing receipts for cash collected, but a cash receipt register was not maintained. We could not determine that cash receipts were used in numerical sequence for proper accountability.

**Cause:** For more than five years prior to fiscal year 2005, SYWA had operated with no full-time employees. The Authority had no general manager, but had two employees on payroll who for a while did nothing more than install meters for new customers and prepared and sent out monthly billings. Then in 2004, even the meter reading and billing were neglected altogether. This continued until March 2005 when one of only two water well pumps broke down placing the system on water hours.

A small group of concerned customers took it upon themselves to restore the system to 24 hour water service. A look at the bank accounts showed very little cash available to replace the pump and to allow for continued payment of the Authority's utility expenses. The dismal state of affairs prompted the group to call for the formation of a new board of directors. This board began actively meeting to address the crisis in May 2005. The current general manager and meter reader was not hired until fiscal year 2006.

Therefore, the lack of accounting policies and procedures in place is due to the lack of any real operation for the most part of fiscal year 2005. Accounting records that might have been maintained previously have since been lost. Policies and procedures relating to administrative and accounting tasks were least on the minds of the new board members who were primarily concerned with obtaining funding to ensure the continued operation of the Authority.

**Effect:** The Authority does not have the capability for internal and external financial reporting. Thus, there is no assurance that revenue generated by the entity would be spent for authorized purposes and that funds received from outside would be properly administered.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## Finding No. 13 (cont.)

**Recommendation:** We recommend that the Board of Directors immediately formulate and adopt policies and procedures to ensure that adequate accounting controls are in place to safeguard and properly account for assets and to allow for reliable and accurate accounting and financial reporting. Some of the basic policies and procedures that should be immediately adopted are related to the receipt and disbursement of funds. For example:

- (1) Ensure the availability of official pre-numbered cash receipts for the Authority
- (2) Require that all cash received are receipted and that receipts are issued in sequence
- (3) Ensuring that cash received are safeguarded against theft or loss and that collections are timely banked.
- (4) Require that a cash register is maintained of monthly collections.
- (5) Require a person independent of the cashier review deposits to make sure that all cash received are deposited to the bank.
- (6) Require original invoices or other authoritative underlying documentation to support each and every disbursement of funds
- (7) Specify the dollar threshold or type of expenditures requiring prior board approval
- (8) Adopt a purchase order system to ensure funds availability and proper authorization before goods or services are acquired
- (9) Ensure that the stocks of blank checks are secured at all times.
- (10) Cash flow management to prevent cost overruns and disruption to public services.

## FINDING NO. 14 - BANK ACCOUNT RECONCILIATION

**Criteria:** SYWA should ensure that bank reconciliation is performed each month as bank statements become available.

**Condition:** SYWA had never reconciled its bank accounts and had had to rely on bank to provide bank account balances as needed.

**Cause:** No one required bank accounts to be reconciled on a regular basis.

**Effect:** Because reconciliation of the two bank accounts was never done, SYWA was not able to timely detect unusual cash transactions.

**Recommendation:** In order to account for all cash transactions, we strongly recommend that the SYWA management and the Board of Directors immediately hire someone with sufficient bookkeeping skills to perform accounting and administrative tasks. One such task should be the reconciliation of bank accounts. The General Manager should always review and approve reconciliation performed by the clerk in order to timely detect errors and unusual activities.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## FINDING NO. 15 – EMPLOYMENT RECORDS

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

**Condition:** From October 2004 to February 2005, SYWA paid \$2,243 to its one employee – a meter reader. We could not find any documentation showing the employee's authorized hourly rate. Neither could we find timesheets to indicate that the employee actually reported to work during the period. We do know that SYWA did not bill customers for water service during the period that the meter reader was on payroll. The Board members have indicated that the employee is no longer working for the Authority, but no personnel action was prepared to that effect. We did notice that the employee's pay check stopped in February 2005, although we knew he was helping the new board members in April 2005 to restore 24-hour water service.

In fiscal year 2006, SYWA hired a general manager, an office clerk and a meter reader. We did not find personnel files containing employment applications, personnel actions or contracts to document employees authorized pay rates. In addition, SYWA did not have any document that would provide information on employee benefits, i.e. annual and sick leave benefit.

**Cause:** It appears that the SYWA management hired and fired its employees without committing anything to writing.

**Effect:** Not maintaining complete employment records increases the risk of unauthorized pay increases or employment benefits.

**Recommendation:** We recommend that SYWA utilizes Yap State Government personnel policies and forms and immediately prepare personnel actions or contracts for the current employees until such time SYWA Board establishes personnel policies and procedures for the Authority.

## FINDING NO. 16 PAYROLL WORKSHEET

**Criteria:** Proper internal controls require that payroll worksheets be prepared to reflect actual hours worked, authorized hourly rate, gross wages, deductions and net wages for each pay period.

**Condition:** We found no evidence that SYWA maintained payroll worksheet showing how the net pay for employees was derived.

**Cause:** There was no controls in place requiring management to ensure that payroll worksheets were prepared to enable the Board to determine the accuracy of payroll checks.

**Effect:** Such practice increases the risk of fraud or errors in the preparation of payroll checks.

**Recommendation:** We strongly recommend that the Board of Directors require management to prepare payroll worksheet and attach it to payroll checks prepared for Board member review and approval.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
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## FINDING NO. 17 FIXED ASSET REGISTER

**Criteria:** SYWA should maintain a fixed asset register for recording its fixed assets and costs to enable management to determine depreciation expenses and value of fixed assets.

**Condition:** SYWA did not have a fixed asset register nor did it have information on types of assets owned by the Authority since inception, source of funding used to acquire such fixed assets. Neither was there information on the historical costs of the assets, their acquisition dates, and estimated useful lives and disposal.

**Cause:** The Authority had never maintained a fixed asset register.

**Effect:** There is no assurance that all assets and equipment purchased with Authority funds or donated to the Authority since inception were properly disposed.

**Recommendation:** We recommend that SYWA hire a capable person who could maintain SYWA accounting records including a fixed asset register and depreciation schedule. Furthermore, inventory of fixed assets should be done periodically and be compared to the fixed asset register.

## FINDING NO. 18 – COMPLIANCE WITH TAX LAWS

**Criteria:** Management has a responsibility to ensure compliance with applicable laws and regulations.

**Condition:** From October 2004 to February 2005, SYWA paid \$2,243 to its one employee. We found no evidence that payroll taxes were withheld from the employee's paycheck. Disbursements during FY05 showed two payments to Social Security but we did not find any records that would help us determine to which tax quarters the payments were related. We did not find any payments to FSM Customs and Revenue for income taxes indicating that income tax was not withheld from the employee's pay checks. If taxes were withheld, however, then an unrecorded liability exists to the FSM Customs and Revenue for an indeterminable amount.

**Cause:** Payroll records for the Authority were inadequate to ensure compliance with FSM tax laws.

**Effect:** There is a risk that the Authority was not in compliance with FSM tax laws during fiscal year 2005 subjecting the Authority to the risk of penalties from the Social Security Administration and the FSM Customs and Revenue.

**Recommendation:** We recommend that the Board of Directors require the general manager to ensure that taxes are withheld from employee's paychecks and that such taxes are remitted on a quarterly basis to the appropriate tax authorities.

# SOUTHERN YAP WATER AUTHORITY

Schedule of Findings  
September 30, 2005

## FINDING NO. 19 – CUSTOMER ACCOUNTS

**Criteria:** The Authority should maintain accurate and reliable records of customer accounts.

**Condition:** From fiscal year 2004 through June 2005, the Authority neglected to read meters and bill its water customers. An attempt to resume regular billing was made in June 2005. June meter readings were taken to establish beginning balances and a second billing in February 2006 resulted in usage data from June 2005 to February 2006 that was finally billed to customers. The new board of directors who had initiated the effort to resume regular customer billing agreed to forgive unbilled and unpaid water usage existing before June 2005. No one considered the fact that some water customers had been making allotments to the SYWA account even during the period of no water bills.

**Cause:** Individual customer ledgers were not maintained by the Authority to track customer balances.

**Effect:** The SYWA does not have reliable records of accounts receivable from its customers. In addition, those customers who had authorized payroll deductions to the SYWA bank account are placed at a disadvantage since no records are available to track the running balance of their accounts with the Authority. The total deposited to the Authority's savings account in FY05 through payroll allotments from six customers was \$431.

**Recommendation:** We recommend that the SYWA review the account status of the six customers who had ongoing payroll deductions during fiscal year 2005 and appropriately give them credit for amounts received over their current bill. In addition, we recommend that the Board ensure that steps are immediately taken to create customer subsidiary ledgers for the Authority to ensure that reliable receivable balances can be generated in the future.

**SOUTHERN YAP  
WATER AUTHORITY**

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September 4, 2006

Ms. Gertrude Gootinan  
Yap State Public Auditor  
Yap State Government  
P.O. Box 927  
Colonia, Yap, FSM 96943

Re: Response to draft audit report for  
fiscal year ending on September 30, 2005.

Dear Ms. Gootinan:

This letter lays out the responses of the Southern Yap Water Authority to the findings contained in the draft audit report on SYWA for fiscal year ending on September 30, 2005. For purposes of convenience, SYWA has categorized the findings in two ways.

The first category directs attention to the shortfalls of SYWA in its operational and administrative affairs. This category consists of findings nos. 1, 2, and 11 through 19.

The second category comprises of findings that lodge serious allegations of fraud, nepotism, and official misconduct against SYWA and some members of its Board of Directors. These are findings nos. 3 through 10.

We concur with the findings in the first category. SYWA has taken the recommendations as regards these findings to heart. Best efforts will be exercised to implement them.

SYWA, however, is stunned by the highly accusatory opinions formulated in the draft audit report around the facts that give rise to the findings in the second category. In our minds,



these facts are not the malfeasances that the draft audit report seemingly paints them to be.

We were appointed in April, 2005, as the new Board of Directors. This was a time when SYWA was literally in crisis, inching toward complete collapse. SYWA was alarmingly understaffed. It had no general manager, and had only one staff, a meter reader. Typhoon Sudal had just destroyed SYWA's office, its vital office equipments, and its water transmission and distribution building. Two of the three SYWA water pumps were already broken down. With only one water pump working, SYWA was no longer capable of maintaining around the clock water provisions to its service communities. Water flow to the service communities were being rationed twice for a few hours most days, and some days there was just no water provision to the service communities.

Inarguably, there was a pressing need to immediately repair the destruction inflicted by Typhoon Sudal, and replace the two broken water pumps. But the previous Board and management had left SYWA behind with less than \$3,000 in cash assets and more than \$6,000 in debts and liabilities. This fact, coupled with the inconvenience caused by the water hour rationing, led to a heavy loss of community confidence in the very survival of SYWA. Some SYWA communities had already begun debating whether or not to turn over control and management of the system to YSPSC.

Hence, when we took over as the new Board of Directors, one of our goals was to immediately restore SYWA back to normal operations. To do this, we needed to quickly repair the destruction caused by Typhoon Sudal, and replace the two broken water pumps. What we needed to do required funding ... funding which SYWA did not have.

Of three things we were certain. First, we knew we needed to request funding elsewhere. Second, we knew that any funding request would take time going through a review process. And third, obvious that a positive review outcome can never be guaranteed, we knew we could not afford to wait on a funding review process in hope of a favorable outcome. We decided to consider other options.

In a Board meeting duly held by quorum, it was agreed that -- since the chairman of the Board had the existing personal means -- he was to proceed and repair the office building. SYWA would apply for FEMA funding, and, if granted, the chairman would be reimbursed for his expenses. Second, it was decided

that SYWA was to immediately resume billing<sup>1</sup> customers, and try to generate the revenue necessary to purchase two new water pumps as quickly as possible. In the meantime, SYWA would submit a budget request to the State government for water pumps and other essential items.

Although the decision to have the chairman perform the repair work on the office was never transcribed into minutes, the decision was, nevertheless, formally made by majority vote of the Board in a meeting duly held. SYWA's failure to transcribe the decision into minutes was never motivated by a fraudulent or otherwise improper design as the draft audit report implies.

The decision was reached at a time when the Board was under tremendous pressure to quickly restore SYWA to normal service capacity, at a time when SYWA had but only a meter reader for a staff, and at a time when the Board members were also tied up in other occupational capacities. These factors were the primary reasons why the Board failed to make minutes of the decision.

Be that as it may, the decision to immediately hire the chairman to repair the office was born out of what the Board genuinely believed was a necessity in order to promptly move towards restoring SYWA to normal operations. Even though the draft audit report avers otherwise, there was never an intent on the Board's part to defraud or circumvent the required bidding process.

When the chairman completed repair work on the office, he had incurred costs and expenses in the amount of \$5,080. This sum is an aggregate of the retail value of the chairman's own materials that he used on the office repair project, the value of materials which the chairman charged to his own personal credit accounts with vendors for the project, and the labor costs of the chairman's construction employees who repaired the office.

By this time, FEMA had approved a \$2,036.60 grant for the SYWA office, and a \$2,913.66 grant for the water transmission and distribution building, for a combined grant total of \$4,950.26.<sup>2</sup> The office grant alone was far short as an equitable reimbursement for the chairman's costs and expenses. For this reason, the Board agreed, again by majority vote in a meeting

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<sup>1</sup>The previous Board and management had ceased billing.

<sup>2</sup>See FEMA PW Nos. 127 and 146.

duly held, to request re-scoping of the office PW to include the grant under the transmission and distribution building PW. While this would not give the chairman complete reimbursement, it would enable him to recover more of his costs and expenses than he would otherwise recover. This decision was made easier by the Board's assessment that the repair of the transmission and distribution building can be delayed, pending further funding, without causing further stresses on SYWA's service capacity.

When FEMA approved the re-scoping request, the chairman applied for the combined \$4,950.26 grant. He was informed by a local FEMA supervisor that there would be an appearance of a conflict of interest if he were to execute the required contract document as the contractor. This FEMA supervisor advised the chairman to have a third party sign the contract as the contractor, and then have that third party transfer the grant payment over to him. This is how the events unfolded to include JG Construction.

Given the uncomfortable scenario of asking a complete stranger to sign a contract which he would not actually perform and benefit from, the chairman asked the owner of JG Construction, who is a relative of his, to perform the role recommended by the local FEMA supervisor. JG Construction perfected the contract document, received the \$4,950.26 grant payment, and turned it over to the chairman as his reimbursement.

The draft audit report implies that the insertion of the State contract bid threshold of \$10,000 in the contract document signed by JG Construction was a deliberate act on the part of SYWA, designed to ignore the lower bid threshold of SYWA's enabling legislation and, thus, circumvent the bidding requirement. This is untrue.

The contract was drafted and reviewed by the government for SYWA. This being so, SYWA had to assume that the language of the contract was sufficient. At no time did SYWA possess any intent to circumvent or defraud the bidding laws. To the contrary, the Board gave the office project to the chairman genuinely convinced that doing so was a matter of urgent necessity and in the best interest of SYWA. The chairman did not personally profit from this decision. He, in fact, lost money completing the repair of the office.

The draft audit report alleges the awarding of the contract to JG Construction to be a shady decision by only "... one or two members of the Board of Directors," devised to mask the fact that the actual work was performed by the chairman. In making this allegation, your auditing staff chose to ignore the facts explained above. The Board made these facts known to her during her investigation.

Further, the draft audit report indicts the chairman of failing to purchase and equip the office with a computer the funding for which had been given under the re-scoped PW. Again, this is not true. Given the fact that the FEMA grant was not enough to cover the chairman's actual costs and expenses for the repair of the office, the chairman would have suffered even greater loss if a new computer were to have been bought. Hence, a used, but still completely functioning, computer was bought instead.

At the time of the purchase of the computer, the Board had yet to hire a general manager. The more urgent functions of the general manager were performed by the chairman, usually outside the hours of his personal occupation. This meant that it was more convenient that he do most of the work at home. For this reason, it was decided that the chairman would keep the computer at home until such time that a general manager is hired.

Finally, the draft audit report accuses the Board of nepotistic hiring. In regards to the hiring of a clerk, the report states that "... no attempt (was made) to hire the best available person for the position of the office clerk by advertising the vacancy.. Instead, a relative was recruited who was obviously not the best candidate for the position." This statement neglects the truth... truth made known to your auditing staff.

The Board announced the vacancy and solicited applications through radio announcements for a period that ran over 30 calendar days. By the end of the announcement period, SYWA had received 4 applications. In a meeting duly held, the Board reviewed these applications and, by majority decision, filled the vacancy. Subsequent events of embezzlement of SYWA funds, totaling \$1,407.90, by the person hired would reveal her to be of poor integrity.

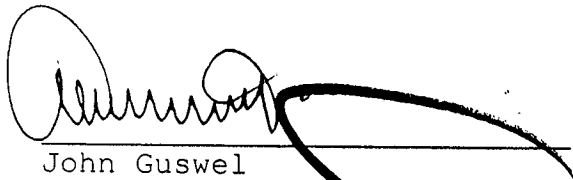
However, when it decided to hire her, the Board was of the genuine opinion that she was, among the 4 applicants, the most suited for the position. She was immediately terminated when

her embezzlement was discovered. And her family has paid SYWA complete restitution in cash for the embezzled funds. But the point here is that the Board did not hire her simply because she is a relative.

While the Board did not use best practices in implementing some of its functions, it has always acted openly and in the best interest of SYWA. The members of the Board, either individually or as a whole, have never acted for personal gains, nor have ever knowingly or intentionally committed frauds or other improper acts. Every action that the Board has undertaken has been triggered by a genuine desire to quickly restore SYWA to full service capacity, and to promote its welfare and that of its service communities. To this end, SYWA will continue to seek the good assistance of your office to help set up its accounting policies and procedures.

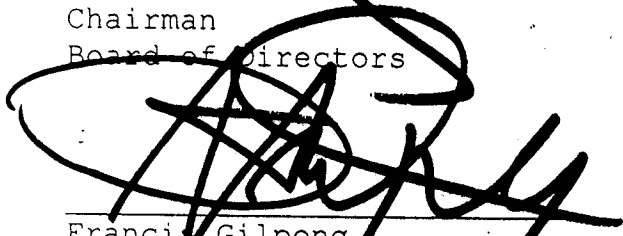
If you have any questions or comments, please do not hesitate to contact us. Thank you very much.

Respectfully submitted,



John Guswel  
Chairman  
Board of Directors

Date: 9/4/06



Francis Gilpong  
Vice-Chairman  
Board of Directors

Date: 9-4-09



Domingo Techar  
Secretary  
Board of Directors

Date: 9/4/06

Stan Lubumad  
Stan Lubumad  
Member  
Board of Directors

Date: 09/04/06

John Gilsowuth  
John Gilsowuth  
Member  
Board of Directors

Date: 9/04/06

Jack Moorou  
Jack Moorou  
Government Representative  
Board of Directors

Date: 9.04.06

Through,

Thomas Falngin  
Thomas Falngin  
Chief  
Rull Municipality

Date: 08-04-06

Joachim Gadad  
Joachim Gadad  
Chief  
Kanifay Municipality

Date: 9/04/06

James Limar  
James Limar  
Chief  
Gilman Municipality

Date: \_\_\_\_\_



# OFFICE OF THE PUBLIC AUDITOR

## YAP STATE GOVERNMENT

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### PUBLIC AUDITOR'S COMMENTS

I would like to thank the SYWA Board of Directors for their prompt response to the audit findings. However, I think it regrettable that the Board of the Southern Yap Water Authority has chosen to dismiss our findings and recommendations on this the first ever audit of the Southern Yap Water Authority as inflammatory and accusatory. By doing so, the Board and management may miss the opportunity to improve the operations of the Southern Yap Water Authority. We reported what we found in the hope that our findings and recommendations would lay the groundwork for policies and procedures that would ensure the future success of the operation of the SYWA in compliance with applicable laws and regulations.

Laws and regulations applicable to financial management and record keeping are the government's means of preserving the public confidence in the management of public entities. The Southern Yap Water Authority is a public enterprise. Therefore, it is management's responsibility to ensure that the laws intended to mitigate the risk of fraud, nepotism, and conflicts of interest are followed. If emergencies had been the cause of the noncompliance with laws and regulations reported, adequate documentation should have been maintained on file to maintain transparency. Unfortunately, the SYWA has been unable to provide us authoritative documentation to help eliminate the appearance of fraud, nepotism and conflicts of interest in the events that took place in fiscal year 2005 and the first part of fiscal year 2006.

Before we issued the final draft on which the Board responses were based, we met with the SYWA Board of Directors to discuss our preliminary findings and recommendations in an effort to understand what took place during fiscal year 2005. We rewrote our final draft to take into consideration the additional information and documentation we had obtained from the Board as a result of that meeting. We resubmitted the revised draft to the Board with a request for a final exit conference. But the Board only prepared and submitted written responses without answering our request for an exit conference. Since then, neither the Board of Directors nor the management of the Southern Yap Water Authority has provided additional information to cause us to change our understanding of the facts as reported in our audit of the Southern Yap Water Authority for the year ended September 30, 2005. Therefore, our report stands as written.

We welcome the opportunity to report on the operations of the Southern Yap Water Authority for the year ended September 30, 2005 for the benefit of the Board of Directors and management of the Southern Yap Water Authority, the State leadership and the customers of the Southern Yap Water System.

Gertrude Gootinan  
Public Auditor