

**YAP STATE
GOVERNMENT EMPLOYEES**

HOURS PAID VS. HOURS WORKED
September 30, 2007



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EXECUTIVE SUMMARY

The Office of the Yap State Public Auditor has issued the final report on its performance audit on Government Employees' time and attendance. We conducted the audit pursuant to title 13, Chapter 7, Section 703 (a) and (b) of the Yap State Code, which states in part:

- (a) *"Inspect and audit all accounts, books, and other financial records of the State Government to include but not limited to, every branch, department, office, political subdivision, board, commission and agency, and other public legal entities or non-profit organization receiving public funds from the State Government, and to prepare written reports of such inspections and audits for presentation to the Governor and the Legislature."*
- (b) *"Inspect and audit personally, or by his duly authorized assistants, the fiscal books, records, and accounts of all custodians of public funds, making independent verification of all assets, liabilities, revenues, expenditures, and obligations of the State Government and agencies thereof."*

Furthermore, we performed the audit in accordance with the standards for performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. We evaluated the systems of internal controls ensuring compliance with the Yap State Public Service System Regulations, and Yap State Laws relating to the process of paying employees within the Yap State Government.

In fiscal year 2007, there were 1,088 government employees or a 65% increase over the State's goal of no more than 660 employees established ten years earlier in 1997 under the Voluntary Early Retirement (VER) program. The State Government paid a total of \$7.6 million in salaries which constituted 34% of total annual expenditures. The increments in annual salaries and wages expenditures in FY2001 to FY2007 as compared to FY2000 ranged from 7% to 57%. This steady increase in salary and wages is contrary to normal expectation considering that the Wage Freeze Policy (EO#01-96) adopted as part of the Voluntary Early Retirement program was intended to control salaries and wages to levels that could be sustained by the State Government.

The objective of this audit is to determine whether or not salaries and wages paid in fiscal year 2007 from the General Fund and the Compact Sector Grants were based on actual hours worked, and if not, to estimate the dollar value of the hours paid to employees in excess of actual hours worked. Since majority of the salaries and wages were budgeted under the State General Fund and Compact II Sector Grants, we limited the scope of the audit to these funds and selected fiscal year 2007 as the test year.

Using a random number generator, twenty six (26) divisions and sixty (60) employees of the State Government were randomly selected for testing. The random selection is important because it ensures that every division and employee within the test population has an equal chance of being selected, ensuring that the results of the sample would be representative of the whole State Government employee population.

I. Summary of Audit Findings:

- A. Review of daily time and attendance and payroll records for two pay periods in fiscal year 2007 found that 78% of the 60 employees did not have daily time and attendance to support the hours for which they were paid or existing records of time and attendance were clearly fabricated. Only 22% of the 60 employees maintained good daily time and attendance, however, there were instances that calculation of hours worked were inaccurate.
- B. When the overpayments for the sampled sixty employees were projected on the 1,088 employees on the State payroll for 2007, inadequate controls over time and attendance is estimated to have cost the State \$1,131,520 for fiscal year 2007 alone.
- C. Had adequate time and attendance records been properly and accurately maintained, large amount of the overtime hours would not have qualified as such and leave hours not applied toward hours not worked would not have been accumulated and cashed-out upon termination of contract.
- D. PSSR employees have the added burden of having to work eight hours a day, five days a week, yet the pay scale to which such employees are subjected has not been changed for over three decades, positions under the PSSR are least desirable and employers desiring to attract better candidates would prefer for new positions to be exempted from the PSSR to avoid following the salary scale.
- E. Reviews and test found that the decrease in the number of employees currently being required to maintain accurate daily time and attendance records is a consequence of the decrease in the number of employees who are clearly "non-exempt" (PSS) employees. Accordingly, of the 1,088 positions existing in fiscal year 2007, we estimated that approximately 774 positions or 71% were exempt from the PSSR.
- F. We found that there is no substantial and consistent difference between the terms of employments for "exempt" (salaried) and "non-exempt" (waged) employees.

II. Conclusion and Recommendation:

As a result of our review and tests of time and attendance records of sampled State government employees, we conclude that salaries and wages paid during FY2007 by the General Fund and Compact Sector Grants were not totally based on actual hours worked due to various factors and the effect of such on the State Government is estimated to be in excess of \$1.1 million for fiscal year 2007 alone.

Therefore, we strongly recommend that *a detailed study and review of the current classification of positions within the State Government be undertaken in order to come up with an amendment to the Public Services System.*

III. Other Matters

Other issues were addressed as part of the report, which does not have a direct impact on our audit objective, but should be taken into consideration since these also contributed to the financial impact on the salaries and wages expenditures for fiscal year 2007.

We met with the Governor and the Cabinet members to discuss our findings and recommendations. Written responses are presented as part of the audit at the end of the report.

We thank the Governor and the Cabinet members for the courtesy and cooperation extended to us during our audit.

Respectfully submitted,



Wilfred Oliver L. Dolosa
Acting Yap State Public Auditor

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PART 1 INTRODUCTION

In fiscal year 2007, the State Government paid a total of \$7.6 million in salaries which constituted 34% of total annual expenditures. Of the \$7.6 million, 32% or \$2.5 million was paid from the State General Fund, 52% or \$3.9 million from Compact II Sector Grants and the remaining 16% or \$1.2 million was paid directly or through the FSM National Government from US Federal or other US Grants, other governments and funds specifically for capital improvement projects.

In fiscal year 2007, a total of 1,088 employees were on the State Government's payroll. According to payroll records, the breakdown by funding sources was as follows:

General Fund	310 employees
Compact Sector Grants	690 employees
Other grants	88 employees

The 1,088 employees in 2007 represents a 65% increase over the State's goal of no more than 660 employees established ten years earlier in 1997 under the Voluntary Early Retirement (VER) program. The 1,088 employees consisted of short and long-term contract employees and permanent employees of the public service system. The increments in annual salaries and wages expenditures in FY2001 to 2007 as compared to FY2000 ranged from 7% to 57%.

The steady increase in salary and wages is contrary to normal expectation considering that the Wage Freeze Policy (EQ#01-96) adopted as part of the Voluntary Early Retirement program was intended to freeze the public service system from creating additional positions, awarding promotions, reclassification and class reallocation – in short to control salaries and wages to levels that could be sustained by the State Government.

Often when governments adopt cost-savings policies, inadequate consideration is given to hidden costs that may arise as a consequence of the cost-saving policies that have been implemented. We believe that poor employee morale which led to lowered productivity in the workplace has been a very real consequence of the voluntary early retirement program and the ten-year old wage freeze policy that was adopted during the Public Sector Reform Program. When employees believe that they are not obtaining fair compensation for their services, often they would resort to practices that would lower the margin between what they believe their services to be worth and the actual amount of their compensation. This audit was performed with the intention of quantifying one such hidden cost of the 30-year old PSS policy – the financial impact on the Government of employees claiming hours for which they were not actually at their worksite.

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PART 2 AUDIT OBJECTIVE

The objective of the audit was to determine whether or not salaries and wages paid during FY 2007 by the General Fund and Compact Sector grants were based on actual hours worked, and if not, to estimate the dollar value of the hours paid to employees in excess of actual time worked.

2-1. AUDIT SCOPE AND METHODOLOGY

We conducted this audit in accordance with standards for performance 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 that evidence obtained is sufficient and appropriate to support the auditor's findings and conclusions. Thus, the sufficiency and appropriateness of evidence needed and tests of evidence varied based on the audit objective, findings and conclusions. We evaluated the system of internal controls ensuring compliance with the Yap State Public Service System Regulations, and Yap State Laws relating to the process of paying employees within Yap State Government.

We performed a preliminary survey by interviewing key personnel from 10 divisions which were randomly selected. We also physically observed employees arriving to and departing their work premises for a whole week at certain of the ten divisions. The objective of the preliminary work was to obtain a better understanding of the various departments and offices' procedures and practices for maintaining time and attendance records. The results of our survey clearly indicated inadequate maintenance and documentation of employees' daily time and attendance records. Consequently, we focused our audit on determining the reliability and accuracy of hours reported to Finance for payroll processing.

Since the majority of the salaries and wages were budgeted under the State General Fund and Compact II Sector Grants, we limited our scope to these funds and selected fiscal year 2007 as the test year. We reviewed time and attendance records from two payroll periods beginning August 19 to September 15, 2007. We obtained financial information from the Office of Planning and Budget to identify government divisions and offices which personnel expenditures were budgeted under the State General Fund and Compact II Sector Grants in fiscal year 2007. For these divisions, we obtained general ledger details of personnel expenditures as well as the current personnel listings from the Office of Administrative Services.

The executive, legislative, judicial branches of the government, the two traditional councils, the Office of the Public Auditor, Boards and Commissions such as EPA and HPO comprise fifty-three different activities with separate budgetary accounts maintained by the State Financial Management System. The financial reports at Finance showed that payroll for these fifty-three (53) divisions are charged to General Fund and Compact Sector Grants.

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Using a random number generator, we randomly selected twenty-six of the fifty-three (53) divisions for further testing. From the personnel listing of government employees that we obtained from Personnel Division, we isolated the employees of these twenty-six divisions which numbered 411 in all. Again using the random number generator, we randomly selected sixty (60) of the 411 employees for whom we were to compare payroll records to actual timesheets. The random selection is important because it ensures that every division and employee within the test populations had an equal chance of being selected, ensuring that the results of the sixty (60) samples would be representative of the whole State Government employees population.

2-2. DISCUSSION OF FINDINGS

Below is a summary of results of our review of the daily time and attendance and payroll records for the sixty employees tested for pay period 18 and 19 of fiscal year 2007:

- **26% did not have any daily time and attendance to support the hours for which they were paid.** Payroll hours submitted to Finance were not supported by daily time and attendance reports. Employees automatically received 80 full hours for the pay period even though there were no records of their attendance. Leave balances were only deducted when supervisors required leave slips for absences hence, employees' leave balances remain intact when supervisors don't require leave slips for their absences.
- **52% were paid for hours that were clearly fabricated.** Payroll hours submitted to Finance were based on daily time and attendance reports which showed all employees exactly at 7:30 to 11:30 and 12:30 to 4:30 every day of the week unless they were absent for a full day or 8 hours.
- **22% had good daily time and attendance records** in place, but calculation of hours worked sometimes were inaccurate. Hours short of eighty (80) hours for the pay period were charged to employees sick or vacation leave balances

We observed employees of two divisions arriving and departing their work sites over a course of four days for comparison with time worked as reported on timesheets. Given the foregoing procedures and our general observations and knowledge of employee routines, we estimate that the average government employee works only six hours a day, but is paid for eight full hours.

Applying this observation for the sixty (60) employees tested, we roughly estimate that the Yap State Government overpaid each of these employees by approximately \$4.00 per day based on their average hourly rate of \$2.00 or \$40.00 each employee each pay period. ***These figures may seem insignificant, but multiplied by 26 pay periods the estimated overpayment***

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translates to \$1,040 annually per employee or \$62,400 for all 60 employees. When the overpayments for the sixty employees are projected on the 1,088 employees on the State payroll for 2007, inadequate controls over time and attendance is estimated to have cost the State \$1,131,520 for fiscal year 2007 alone.

Table 1 – Estimated overstatement in salaries

Number of employees		Individual employee	Sampled employees	Employees paid under Gen & Compact	Total employees listed in FY07
		1	60	411	1088
Overstatement per hour		2.00	120.00	822.00	2,176.00
Overpayment per day	2 hours	4.00	240.00	1,644.00	4,352.00
Overpayment per pay period	10 days	40.00	2,400.00	16,440.00	43,520.00
Annual overpayment	26 PPs	1,040.00	62,400.00	427,440.00	1,131,520.00

PART 3 WHO MUST KEEP DAILY TIMESHEETS? One of the challenges we faced when we set out to perform this audit was the lack of documentation on personnel actions and contracts identifying the specific positions which paid hourly wages and hence should be working eight-hour days in order to earn full pay. In fact, we believe that the general indifference of supervisors towards the maintenance of accurate daily time and attendance reports not only stems from a lack of understanding of the importance of accurate timesheets for wage earners, but it is also the result of the lack of any real differences between the responsibility of “exempt” and “nonexempt” employees under the Public Services System to maintain accurate time and attendance reports. The remainder of this report explores the question raised in the title of this section and discusses the progressive blending of rights and obligations of “exempt/nonexempt” employees as the primary cause for the lack of adequate time and attendance records for government employees.

3-1. EXEMPT AND NONEXEMPT EMPLOYEES

In the United States, the Fair Labor Standards Act (FLSA) requires employers to classify all job positions as “*exempt*” and “*nonexempt*”. *Nonexempt* employees must be paid at least the federal minimum wage. Moreover, if a *nonexempt* employee works over 40 hours a week, he must be paid overtime at one and a half times his hourly rate.

Positions *exempt* from the FLSA were uncommon as they must be associated with jobs that require “discretion and independent judgment” such as for executive, administrative, professional, and a few other positions. Moreover, the exempt employee must be paid an

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annual salary (not hourly wages) of not less than \$455 a week. If an exempt employee misses a day of work, his salary cannot be deducted for the missed days, just like if he works over 40 hours a week, he cannot claim overtime for the extra hours.

The Fair Labor Standards Act is intended to prevent employers from taking advantage of employees. Because most jobs in the U.S. private sector often requires more than 40 hours work per week, the key differences between exempt and nonexempt classification is of key importance for employers and employees.

Despite the FLSA's attempt to govern employer/employee relations, much of the conditions of employment are governed by social convention. The number of employees who take their employers to court for violation of the FLSA is testimony to the lack of clear direction provided by U.S labor laws. In the end, due to exceptions and other details in the laws, exempt positions do not necessarily mean salaried positions, nor are wage employees necessarily in *nonexempt* positions.

The same ambiguity also exists for the Yap State Government where "*exempt*" and "*nonexempt*" classification refers to the applicability of the Public Service System Act and regulations to each job positions. *Nonexempt* employees are those people hired as Public Service System (PSS) employees and subjected to the terms and conditions of government employment as set forth under the Public Service System Act (PSSA) and Regulations (PSSR). Some of the key benefits authorized in the PSSR are as follows:

- Overtime pay for hours worked in excess of a specified number of hours.
- Vacation hours that progressively accumulate at a rate commensurate with the number of years of service. These vacation leave hours are vested rights and the leave hours are cashed to employees upon their termination of employment notwithstanding whether the termination is voluntary or involuntary.
- Permanent employment. Once an employee has passed his probationary period, he is basically secured for the job and could not be terminated without three written warnings. Even after the warnings, a grievance process is allowed to an employee who may wish to contest his termination.

Likewise, in return for the benefits described previously for nonexempt employees, the Public Service System restricts civil employment as follows:

- Pay only for actual hours worked. Because of the overtime and leave benefits, nonexempt employees are required to document the number of hours worked each day and must account for each hour of the workweek for proper payroll processing.

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- Hourly rate must conform to PSS Salary Schedule. Starting compensation and any subsequent adjustments to the pay is restricted to the hourly rate and class and pay levels for similar positions within the government as established by the Chief of Personnel. The objective of this is not only to ensure fair and equitable compensation but is also a means of controlling personnel expenditures.

3-2. EXPECTED DIFFERENCES BETWEEN EXEMPT AND NONEXEMPT GOVERNMENT EMPLOYEES

In order to draw conclusions about the differences between PSSR employees (nonexempt) and exempt employees, we received the common benefits accorded to PSSR employees and the restrictions on compensation from which to compare it with exempt positions to determine if we could identify the salary positions from wage positions. Because it makes little sense to have two classes of employees if both have exactly the same benefits and terms of employment, we made the assumption for comparison purposes, that when a benefit is authorized or restrictions applied to PSSR employees, the opposite would apply to exempt employees, as presented in the table below:

Table 2 – Expected Differences between Exempt and Nonexempt Positions

	Nonexempt (PSSR)	Exempt
Compensation	Based on number of hours worked.	Fixed dollar amount
Hourly rate	Generally lower than salaried employees because of overtime pay eligibility. Must follow PSS salary scale.	Generally higher than waged employees because of the lack of overtime pay. Do not have to follow PSS salary scale.
Workday	Generally, no more than eight hour workdays expected, five days a week. (40 hours/wk)	Workload is expected to exceed the normal eight-hour workday, five-day workweek.
Overtime pay	Overtime rate applies to hours worked in excess of the normal eight hour workday/five days workweek.	Not eligible

From the above, it appears that the employment benefits described for nonexempt employees could only be implemented if the employees were paid on a hourly basis. Therefore, we concluded that nonexempt employees under the PSSR were wage earners and should not be paid until and unless they could provide evidence of the actual number of hours worked. Only reliable and accurate daily time and attendance reports could serve the purpose. YET, as we found in our detailed tests of payroll records, only 22% of employees tested kept adequate time and attendance records.

Although the PSSR categorizes employees into two classes of “exempt” and “nonexempt”, and assumes that the majority of government employees would be subjected to the provisions

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of the PSSR, the personnel actions for the 60 random employees that we tested showed the following:

- 15 or 25% were PSS employees (status shown as “permanent”)
- 7 or 12% were exempted from the PSS
- 38 or 63% were contract employees (some of who were exempted from only certain sections of the PSS)

We concluded as a result of our tests that the decrease in the number of employees currently being required to maintain accurate daily time and attendance records is a consequence of the decrease in the number of employees who are clearly “nonexempt” (PSS) employees.

PART 4 WHY THE DECREASE IN PSS EMPLOYEES?

4-1. ADDITIONAL POSITIONS EXEMPTED FROM THE PSS IN 1997

The original Public Service Systems Act was made applicable to all existing and future employees of positions in the State Government except for elected officials and the members of the traditional councils, special assistants and secretaries of the governor and lieutenant governor, administrative director of the state court and justices and judges, appointed officials such as the head of departments and offices, the public auditor, professional employees under prime contract, contract positions existing at the time of promulgation of the Act and temporary positions.

We estimated that prior to the amendments to the Public Service System Act in 1997, approximately fifty-six (56) positions or 8% of the targeted 660 positions within the government may have been exempted from the Public Service System. But amendments to the PSS Act also exempted the following positions:

- Positions for the legislative counsel and chief clerk
- Positions held by teachers, nurses and police officers
- Positions funded by outside grants

Accordingly, of the 1,088 positions existing in fiscal year 2007, we estimated that approximately 774 positions or 71% were exempt from the PSS.

We compared the key differences between exempt and nonexempt employees that we had developed in Table 1 to the benefits given to contract/exempt employees and our knowledge of practices within the government in general. We found that there were in fact no substantial and consistent differences between the terms of employment for exempt and nonexempt employees.

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- ◆ **Overtime** – One of the key differences between PSSR employees and *exempt* employees was the latter's ineligibility for overtime. Yet we found at least one contract in which the employee was authorized overtime pay. Meanwhile, PSSR employees were discouraged from earning overtime as a matter of policy. Since implementation of the Compact, most departments are no longer budgeting for overtime, except for a few divisions. Moreover, in 1997, amendments to the PSSR reduced overtime from 1.5% to 1.3%. The two groups of employees (nurses and police officers) whose jobs require overtime work were exempted from the PSSR in order that they could retain the 1.5% overtime rate.
- ◆ **Leave Benefits** – Our review of the 38 of the 60 employees tested who were contract employees found that their leave benefits differed only slightly from the leave benefits of the PSSR employees. Only the contract for the cabinet members (the heads of departments and offices) met our expectation for *exempt* employees.
- ◆ **Job Permanence** – We found that the contracts for teachers, nurses, and police officers who were exempted from the PSSR in 1996 did not have expiration dates. Because these positions are necessary full-time positions, there is not much distinction between these and other PSSR positions in terms of permanence.
- ◆ **Payment Method** – Based on the language of contracts, it appears that only PSSR employees are explicitly required to work eight hours a day, five days a week (PSSR 8 6B(2))
 - Some contracts stated, "*Employee shall perform the services in Yap State during regular government working hours*". This is open to many interpretations. Does this mean they could work at home as long as their home is in Yap State? If they perform only one hour's worth of work, would they be paid the amount stated on their contracts?
 - The contracts for nurses stated, "*Employee shall render such duties and responsibilities at the location(s) and time required by employer*". Yet, under the section for compensation, the contract did not state clearly that compensation was to be paid on an hourly basis; the contract instead stated a fixed amount to be paid biweekly, but also went on to mention the possibility of overtime.
 - Some other contracts, including most prime contracts, stated, "*Every effort will be made to maintain a reasonable five-day, 40-hour work week*". On the surface it may appear that this is a salaried position in which the incumbent would not be required to maintain timesheets. Yet, in another section, the contract stated, "*unauthorized leave or leave without pay, recorded as hours not worked, shall be deducted from employee's pay in units of hours, based on his/her hourly rate*".
- ◆ **Salary Scale** – The schedule which determines the starting pay for most PSSR employees was developed over thirty years ago during the Trust Territory administration. Because it is outdated, most employers, desiring to attract better

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candidates, would prefer for new positions to be exempted from the PSSR to avoid following the salary scale.

PART 5 CONCLUSIONS AND RECOMMENDATIONS

Based on what we learned during this audit, we have concluded the following:

- Employees with only personnel action to support their employment with the State Government are “*nonexempt*” (PSSR) employees, whose status is considered “permanent”. These are currently the only employees who are explicitly required to work eight hours a day, five days a week. Whether they are required to keep a record of their attendance to support their paid hours depends on their supervisors.
- “*Exempt*” employees are so identified because there is always a contract attached to their personnel action. None of the contracts that we reviewed clearly stated whether the employee was to be paid hourly wages or a fixed salary. As in the case for “nonexempt” employees, maintenance of daily time and attendance records is dependent on the work ethics of the supervisors.
- Given the mishmash of benefits being allowed to contract employees and the discouragement of overtime for “nonexempt” employees, no real differences exist between “*exempt*” and “nonexempt” positions in terms of benefits. Consequently, because PSSR employees have the added burden of having to work eight hours a day, five days a week, yet the pay scale to which such employees are subjected to has not been changed for over three decades, positions under the PSSR are least desirable.
- During our discussions with employees and employers, most contract employees believe that they are on a salary basis. Because the average government employee is at the office less than 6 hours a day or only approximately 30 hours a week, salaried positions have come to mean positions where a person does not have to work 8 full hours to get a full day’s pay. The leave hours not applied towards hours not worked are accumulated and cashed upon termination of the contract.
- Despite the lack of reliable records of daily time and attendance, we observed that a particular division authorized overtime pay for employees. Had adequate time and attendance records been maintained, a large amount of the overtime hours would not have qualified as overtime. Given the general lack of daily time and attendance records, we believe this division was not alone in authorizing overtime pay when even regular time was questionable.

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Not considering the impact of overtime paid that should not have been paid or leave payouts that should not have been paid out, the effect of poor time and attendance records on the State Government is estimated to be in excess of \$1.1 million for fiscal year 2007 alone.

Therefore,

We strongly recommend that a detailed study and review of the current classification of the positions within the State Government be undertaken in order to come up with an amendment to the Public Service System.

- *The amendment should define the types and nature of positions that can qualify for exemption from the State Public Service System.*
- *Moreover, the benefits of exempt and nonexempt positions should be reviewed in order to strike a better balance between employment benefits and restrictions in the two categories.*
- *If lines between exempt and nonexempt positions are not to be the same as between waged and salaried positions, the appropriate payment method should be clearly identified for each position within the State Government.*
- *In addition, department heads for divisions with waged positions should devise controls to ensure reliable and adequate maintenance of time and attendance records to ensure that such employees are only paid for actual hours worked.*

PART 6 OTHER MATTERS

The issues that will be addressed in this part of the report are issues which would not have a direct impact on our audit objective of determining whether regular time paid to employees is based on actual hours worked but should also be taken into consideration since these also contribute to the financial impact of the salaries and wages expenditure for FY2007.

1. Inconsistencies of Overtime Rates

Three nurses, whose contracts state that overtime rate will be 150% of their regular hourly rate, were paid overtime equivalent to 130% of their regular hourly rate for 2 pay periods. Eight other employees were paid overtime at the rate of 150% of their regular hourly rate for 8 pay periods while for the rest of the pay periods, they were paid overtime at the rate of 130% of their regular hourly rate.

For uniformity and fairness to all employees, there should only be one overtime rate established for all eligible State Government employees. Having different overtime rates

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gives an impression of preferential treatment which could affect the morale of other employees.

2. Control over Overtime Hours

Overtime work as defined in the State PSSR is “work directed to a specific objective and goal which cannot be accomplished during the regular workday”.

Review of overtime work justifications and authorizations revealed that a secretary and a receptionist, who were employed on a contractual basis, were paid 59 overtime hours during pay periods 18 & 19 though they are not eligible for overtime. The reasons for their overtime, which were to file the day’s communications and correspondence and to complete outstanding work, should not be considered since these tasks are included in their regular day to day function.

For the same pay periods, an engineer had 65 overtime hours to do the work required of him to perform during regular working hours. This employee started to work additional 2 hours during weekdays and 8 hours on Saturdays immediately after he was granted overtime privileges thru a justification letter duly approved by the Governor. Proper controls should be established in determining the eligibility of the extra hours for overtime pay, whether the work being accomplished cannot be done with-in the regular working hours. Supervisors and department heads should ensure that all overtime hours are justifiable and reasonable.

Employees hired under prime employment contract are not eligible for overtime since they have a fixed annual salary. Giving the overtime privileges will send a negative signal to the majority of the government employees, since it will appear that there are some employees being given preferential treatment.

3. Yap State Government did not utilize its savings after the ERS program to properly train and compensate the remaining government employees.

Yap State obtained a loan from Asian Development Bank (ADB) of \$3.5 million to implement the 1998 Early Retirement Scheme (ERS) program. As of 9/30/99, \$1,969,527 was unused, of which \$1,657,417 was placed as investment and \$312,110 remained in the State’s General Fund. Additionally, the reduction of employees saved the Government approximately \$72,485 in biweekly wages or an average of \$1.9 million in annual wages.

With both savings totaling \$3.8 million, the State Government still failed to train and adjust the salary scale of the employees which in time resulted in more hiring of employees with larger salaries and the continuing decline in the work attitude of the remaining employees.

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4. Time and Attendance Reports for Employees Residing in the Neighboring Islands

Department and division heads for employees residing in the neighboring islands need to develop a more reliable system for monitoring employees' daily time and attendance. Our discussion with timekeepers for two of these divisions found that reliable time and attendance records for neighboring island employees were not received on time for payroll processing. Consequently, timekeepers automatically gave 80 full hours to the employees and when timesheets arrived weeks or months later via the field trip ship, we were told the subsequent payroll hours were adjusted accordingly.

5. Paid Time Off

Our analysis of the use of leave hours for the 26 randomly selected divisions showed that the divisions with more reliable timesheets allocate 6-10% of their biweekly hours to paid time off (vacation leave hours) as compared to 1-5% for those divisions who do not keep time and attendance reports. This is in line with our conclusion that divisions without time and attendance reports do not charge employees' leave balances for tardiness, but report full time for employees who might have worked less than 80 hours biweekly. This practice allows employees to maximize their accumulated leave hours, thus increasing the amount of the State's liability for vacation leave. Vacation leave hours are converted to dollars and reported as a liability on the State's financial statements each fiscal year.

6. State Employees Master List

The State currently does not have a reliable electronic listing of its employees. The Employee Master List maintained on the State's financial management system was not accurately maintained. We found in our review of employees of the randomly-selected twenty-six divisions that the master list did not accurately reflect employees' departments and divisions as well as their "locations", while the "locations" for some employees were left entirely blank. In addition, the employment status of employees was not accurately reflected in the listing as "PSSR", "Exempt", or "Contract". In order for the State to accurately analyze payroll costs, care should be taken to ensure that the information on the master list is accurately maintained.



**OFFICE OF THE ATTORNEY GENERAL
The State of Yap**

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September 26, 2008

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

Re: Response to the 'Hours Paid vs. Hours
Worked' Audit Findings.

Dear Ms. Gootinan:

I concur that there is a general lack of awareness as to the legal distinction between a salaried and a waged employee. As your report cites, this has led to some problems in the way some employees are treated. It is clear in a lot of employment contracts that the term 'salary' has been used loosely to mean compensation, irrespective of whether or not the compensation is intended to be fixed (salaried) or based a unit of time of performance (waged). As you have cited, this has led in some instances to uncertainty as to the type of intended compensation, resulting in some employees intended to be salaried being allowed overtime compensation, and some employees intended waged being paid on an 80-hour biweekly basis without deference to the actual hours they work.

The root cause of the problem lies in the fact that the present legal regime of the State does not define 'salary' or 'wage', nor does it posit the standards to govern the compensations and benefits of contract employees. As a result, the conditions and terms of employment contracts are a matter of negotiations and agreements between the employer and employee,

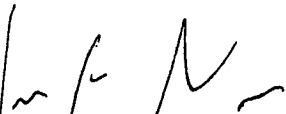
and at times have differed from cases to cases, even in the same position categories. At the very least, we should have legislation setting out, among other things, certain standards which define the class of contract employees to be waged, the class to be salaried, their schedules of compensation and benefits, and other standards of employment as may be necessary.

I have tasked Assistant Attorney General Martin to take the lead in drafting a bill to try and address this concern. We will be consulting with you and others as necessary along the way.

PSS employees are waged as a matter of law. The fact that, as your report points out, some departments are crediting PSS employees for 80 hours of work on a biweekly basis, when they do not actually put in that much time, is a matter of administrative enforcement. I will venture to say that **very** few waged employees put in 8 hours a day, 5 days a week. So there is no question that diligent enforcement is necessary. But I also think that-- given the average rate compensation for State waged employees, and the present rate of the cost of living-- we have to address the enforcement of paying waged employees for actual hours work, but alongside efforts to undertake appropriate wage reforms. As you are aware, the Administration is currently putting together a wage reform proposal for legislative consideration, but this is a discussion for another forum.

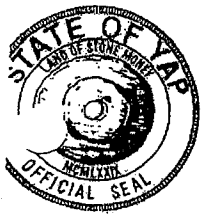
If you have any questions or comments, or if there is any other area in your report that you think I should also comment on, please let me know. Thank you.

Sincerely,



Victor Nabeyan
Attorney General

xc : File



**OFFICE OF PLANNING & BUDGET
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September 30, 2008

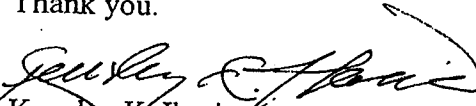
Ms. Gertrude Gootinan
State Public Auditor
Office of the Public Auditor
Colonia, Yap State FM 96943

Dear Madam Public Auditor:

This is a short note to inform you that we do not have any specific comments on the audit report for the Government Employees' Attendance and Performance that your office issued for comments months back. Your presentation at the September cabinet meeting did cleared up some minor questions I had regarding the applicability of the Public Service System and its position classification and compensation structures to the present-day labor and employment standards. Hence, I do agree with your recommendation that an overhaul of the PS System is due anytime with a fair compensation plan that is affordable to the State Treasury and can withstand abuse by government officials.

Your office did a splendid job in analyzing and highlighting the issues facing the PS System and thereto, you and your staff should be commended for a job well done.

Thank you.


Kensley K. Ikosia