

PUBLIC UTILITIES CORPORATION

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2006

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

Board of Directors
Public Utilities Corporation:

We have audited the financial statements of the Public Utilities Corporation (PUC), as of and for the year ended September 30, 2006, and have issued our report thereon dated June 12, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered PUC's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted matters involving the internal control over financial reporting and its operation that we considered to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operations of the internal control over financial reporting that, in our judgment, could adversely affect PUC's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described in the accompanying Schedule of Findings as items 2006-1 through 2006-7.

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 caused by error or fraud in amounts that would 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PUC's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance that is required to be reported under *Government Auditing Standards* which is described in the accompanying schedule of findings as item 2006-1.

We also noted other matters involving the internal control over financial reporting that we have reported to the management of PUC in a separate letter dated June 12, 2007.

This report is intended solely for the information and use of management, the Board of Directors, federal awarding agencies, pass-through entities and the cognizant audit and other federal agencies and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP
June 12, 2007

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Procurement

Finding 2006-1

Criteria: Pursuant to PUC Procurement Regulations and Procedures, procurements shall provide full and open competition among vendors. Any allowable exceptions must be properly documented and approved in accordance with applicable Republic of Palau procurement requirements and such approvals shall be documented in the procurement file.

Conditions: Of twenty-five samples tested, we noted the following:

- For the following item, documentation appears inadequate to support procurement rationale that there is only one reliable source of required goods or services:

<u>Check No.</u>	<u>Ref. No.</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1624	626039	401-7130-131	10/18/05	\$ 15,750

- For one sample, there were no price quotations or procurement documents on file evidencing the procurement rationale.

<u>Check No.</u>	<u>Ref. No.</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
13128	625956	301-7140-421	10/01/05	\$ 6,959

- For five items tested, there was no evidence that the public notice for invitation for bids was adequately advertised and fairly publicized. Further, it appears that related contracts for the following expenditures were not awarded within a reasonable time as required by the procurement regulations.

<u>#</u>	<u>Check No.</u>	<u>Ref. No.</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1	13778	627615	102-7180-121	06/01/06	\$ 10,583
2	657027	627377	000-1332-000	05/01/06	185,811
3	13391	626633	000-1332-000	01/01/06	40,515
4	13275	626542	000-1332-000	12/01/05	61,908
5	13529	626889	000-1332-000	02/01/06	18,755
					<u>\$ 317,572</u>

- For one expense item, there appears to be inadequate documentation supporting the rationale for procurement selection.

<u>Check No.</u>	<u>Ref. No.</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
657027	627377	000-1332-000	05/01/06	\$ 185,811

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Procurement, Continued

Finding 2006-1, Continued

- For five fixed asset acquisitions, there appears to be inadequate documentation supporting the rationale for bids selected. Further, there was no evidence that public notice for invitation for bids was adequately advertised and fairly publicized.

<u>#</u>	<u>Dept. No.</u>	<u>Asset No.</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1	401	4366	000-1608-000	10/01/05	\$ 28,804
2	404	4365	000-1608-000	10/01/05	25,109
3	201	4367	000-1608-000	10/01/05	25,109
4	201	4368	000-1608-000	10/01/05	25,109
5	CIP	na	802-1402-000	10/31/2005	261,484

- For a construction contract involving the construction of PUC's office building, there appears to be inadequate documentation supporting the rationale for procurement selection. Further, our examination of the contract indicated that a performance bond was not obtained as required by PUC's procurement policies for contracts in excess of \$50,000.
- For one fixed asset purchase, we could not locate adequate documentation of the approval of extension of the bidding period to include proposals received after the closing date. Further, there was no evidence that the public notice for invitation for bids was adequately advertised and fairly publicized.

<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
13299	4375	000-1603-000	07/27/06	\$ 67,720

- For one fixed asset acquisition, there was a lack of evidence that the public notice for invitation for bids was adequately advertised and fairly publicized.

<u>Check Nos.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
12343,13287, 13910	4371	000-1608-000	07/14/06	\$ 201,068

Cause: The cause of these conditions is weak controls over ensuring that procurement policies and procedures are implemented.

Effect: The effect of the above conditions is noncompliance with established procurement regulations.

Recommendation: We recommend that PUC strengthen its internal controls over procurement and ensure compliance with established procurement regulations. For exceptions from procurement policy, the reason for the exception should be documented and the exception should be approved by senior management or the Board of Directors.

PUBLIC UTILITIES CORPORATION

Schedule of Findings Year Ended September 30, 2006

Procurement, Continued

Finding 2006-1, Continued

Prior Year Status: Weak controls over established procurement procedures were reported as a finding in the audit of PUC for fiscal year 2005.

Auditee Response and Corrective Action Plan: We concur with the above findings except for matters discussed below. Specifically, we concur that documentation in the past has been weak. The procurement officer has been charged with ensuring proper documentation of all procurements through the use of a control docket, effective immediately.

- Check no. 1624: This contract was consummated by prior management. Present management has taken steps to ensure full compliance with PUC's procurement policy.
- Check no. 13128: As this purchase falls within the "small purchase" category, written quotations were solicited from known suppliers of these products off-island as there are none available locally. Only one supplier responded to the request and consequently was contracted to supply these materials.
- Check nos 13778, 657027, 13391, 13275, 13529: Invitation for bids were publicized according to PUC's policy: in the local newspaper, on the local public radio station (this service is free and therefore there is no documentation to evidence publicity), emails to past vendors, and publication in the Public Power Association (PPA) website (PPA is a networking and publicity arm of Pacific Islands power utilities and related contractors). The procurement officer has implemented a control sheet to document every publication issued for each project.
- Fixed Assets nos. 4366, 4365, 4367, 4368, CIP: Purchases were made by the prior management. Present management has taken steps to ensure full compliance with the procurement policy.
- CIP: The contract was consummated by prior management. The contract has since been rescinded and legal action initiated to recover payments. Present management has taken steps to ensure full compliance with the procurement policy.
- Check no. 13299: PUC has no requirement to justify extensions of bidding periods. An extension may be authorized by management based on business principles.

Management concurs that there is a provision in our procurement policy requiring the contractor's signature to be affixed last on a contract; however, this requirement is a carry-over from when PUC was under national government management. Management believes that the timing of the contractor's signature is irrelevant as PUC is not obligated to honor a contract signed only by the contractor. A review to revise policies is planned.

Auditor Response:

- Check no. 13299: PUC should consider a requirement in the procurement procedures to justify extensions of bidding periods.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Procurement

Finding 2006-2

Criteria: An effective procurement regulation should explicitly provide for policies governing extension of performance for recurring and continuing service requirements.

Condition: PUC's procurement regulations do not explicitly provide for policies governing extension of contracts for recurring and continuing service requirements. The following contract was renewed in accordance with provisions in the contract, but we were unable to verify that the renewal was in compliance with PUC's regulations.

<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
13637	627387	102-7130-132	05/08/06	\$ 5,775

Cause: The cause of the above condition is lack of established policies governing extension of contracts for recurring and continuing services.

Effect: The effect of the above condition is the potential to award contracts without providing for open and free competition.

Recommendation: We recommend that PUC review existing procurement regulations and formulate policies governing extension of contracts for recurring and continuing services.

Auditee Response and Corrective Action Plan: Retaining the same legal counsel is a sound business practice due to the sensitive nature of legal matters and natural costs associated with frequent changes of professional services. Matters not addressed in our procurement policy shall be governed by sound business practices.

Auditor Response: We do not disagree with management with respect to addressing a sound business practice; however, PUC should consider limiting the number of times or number of years recurring service contracts are extended without going through the procurement process.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Disbursements

Finding 2006-3

Criteria: Expenditures should be properly authorized, supported and approved prior to incurrence or payment.

Condition: The invoices, receipts and payment dates for five disbursements precede the dates of the purchase requisition and the purchase order. It appears that the expenditures were incurred and paid prior to obtaining the required authorization and approval.

<u>Dept./Check No.</u>	<u>Asset/Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
401	4366	000-1608-000	10/01/05	\$ 28,804
404	4365	000-1608-000	10/01/05	25,109
201	4367	000-1608-000	10/01/05	25,109
201	4368	000-1608-000	10/01/05	25,109
1624	626039	401-7130-131	10/18/05	<u>15,750</u>
				<u>\$ 119,881</u>

Cause: The cause of the above condition is failure to obtain appropriate approvals and authorizations prior to incurring and payment of expenditures and failure to ensure completeness of relevant supporting documents prior to payment processing.

Effect: The effect of the above condition is a potential for unauthorized expenditures.

Recommendation: We recommend that PUC strengthen controls in place surrounding the disbursement cycle and ensure that all relevant supporting documents are obtained prior to disbursement.

Auditee Response and Corrective Action Plan:

- We concur with the above finding. The post-approved transactions were initiated by prior management. Current management has taken steps to ensure full compliance with PUC's procurement policy and procedures.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Travel

Finding 2006-4

Criteria: All official travel on behalf of or in the interest of PUC should comply with the PUC travel policies and procedures.

Condition: Of four travel expenses tested, we noted the following:

- For three travel expenses, the travel request was completed and submitted for approval less than 30 days prior to travel and there was no evidence that efforts were made to take advantage of discounts and desirable rates for the best interest of PUC.

<u>#</u>	<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1	1659	626022	101-7150-501	10/28/05	\$ 6,095
2	1664	626014	102-7150-501	10/31/05	5,506
3	1645	626031	301-7150-503	10/26/05	<u>3,881</u>
					\$ <u>15,482</u>

- For one travel expense, the traveler was paid per diem rates higher than the established national government rates. Also, a trip report was not submitted along with the travel voucher and such travel voucher was not submitted within 30 days after the official travel. Further, based on the travel voucher, cost of car rental reimbursed appears to be unreasonable considering the days traveled and normal car rental charges.

<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1659	626022	101-7150-501	10/28/05	\$ 6,095

- For one travel expense, the traveler was paid a per diem rate higher than rates set forth in PUC travel policies and regulations. Further, per diem was paid for the traveler's three days of vacation.

<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1664	626014	102-7150-501	10/31/05	\$ 5,506

- For one travel expense, the travel voucher with supporting trip report, boarding passes, receipts and contemporaneous records of taxi fares were not on file.

<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1645	626031	301-7150-503	10/26/05	\$ 3,881

Cause: The cause of the above condition is the lack of enforcement of established travel policies.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Travel, Continued

Finding 2006-4, Continued

Effect: The effect of the above condition is potential noncompliance with applicable travel policies and procedures.

Recommendation: We recommend that PUC ensure that the established travel policies and procedures are enforced.

Prior Year Status: Lack of enforcement of established travel policies was reported as a finding in the audit of PUC for fiscal year 2005.

Auditee Response and Corrective Action Plan:

- We agree with the above finding. Occasionally, Board members authorize their travel with less than 30 days notice as they wait for approval of their leave from their individual workplaces before they notify PUC of their intent to travel. Other matters requiring travel may also occur spontaneously thus making it impossible to meet the 30-day requirement. This section of the travel policy shall be subjected to review and revision.
- For check no. 1659, the national government travel policy contained two different sets of per diem rates and did not specify which set was to be followed. PUC has since learned the appropriate rates to use and is now reimbursing board members at the established per diem rates. A receivable has been recognized for a portion of this travel.
- Check no. 1664 was issued and authorized by prior management. Controls have been reiterated to responsible staff to ensure compliance with policies.
- We concur with the finding concerning check no. 1645. This document was lost while being routed between departments for approval. A logbook has since been implemented to track routing of documents to ensure control over records.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Expenses

Finding 2006-5

Criteria: Expenses should be recorded in the period incurred.

Condition: We noted that three expenses amounting to \$22,766 were incurred in prior year but were recorded upon payment in the current year.

<u>#</u>	<u>Check No.</u>	<u>Ref. No</u>	<u>GL Account</u>	<u>GL Date</u>	<u>GL Amount</u>
1	14007	628019	403-7130-131	08/01/06	\$ 8,423
2	12260	628357	401-7130-131	09/30/06	5,920
3	14007	628019	201-7130-131	08/01/06	<u>8,423</u>
					\$ <u>22,766</u>

Cause: The cause of the above condition is the lack of appropriate cut-off procedures and controls.

Effect: The effect of the above condition is an immaterial misstatement of expenses and liabilities and the potential for unrecorded liabilities.

Recommendation: We recommend that PUC implement appropriate policies and procedures to ensure recording of expenses in the appropriate period.

Auditee Response and Corrective Action Plan: Cut-off procedures are in place, however, the then-Chief Financial Officer resigned shortly after year-end. His resignation disabled enforcement of controls and thus the resulting cut-off errors. Management determined these cut-off matters were not material to PUC as a whole and therefore decided to record the expenses in the current year. Management has already taken steps to ensure compliance with control procedures.

PUBLIC UTILITIES CORPORATION

Schedule of Findings
Year Ended September 30, 2006

Payroll

Finding 2006-6

Criteria: PUC personnel are to be paid based on an authorized rate. Further, the PUC personnel manual requires that all overtime is to be approved in advance by an employee's immediate supervisor.

Condition: Of twenty-five payroll disbursements tested, we noted the following:

- The pay rate used to calculate payroll differs from the approved rate per the approved personnel action form for one employee (Employee No. 6014831, Pay period ending 6/10/2006).
- Overtime authorization forms were approved after the overtime hours were rendered for the following:

<u>#</u>	<u>Dept. No.</u>	<u>Employee No.</u>	<u>Pay Period Ending</u>
1	13	6075430	9/30/2006
2	43	6061951	6/24/2006
3	44	9420000	8/19/2006
4	53	6014831	6/10/2006
5	43	6060673	2/18/2006
6	31	6075570	1/21/2006
7	43	6418085	1/21/2006
8	15	6413653	12/24/2005

Cause: The cause of the above condition is the untimely approval of overtime requests and the lack of oversight by personnel processing and approving payroll.

Effect: The effect of the above condition is a control breakdown over payroll authorization.

Recommendation: We recommend that PUC adhere to its policy on overtime as stated in the personnel manual.

Prior Year Status: Untimely approval of overtime requests and the lack of oversight by personnel processing and approving payroll were reported as a finding in the audit of PUC for fiscal year 2005.

Auditee Response and Corrective Action Plan:

- We concur with the first item. This was a transposition error by the payroll clerk. The matter has been reviewed and a retroactive adjustment will be made to the staff's salary. Controls have been implemented to require a second review of changes made to personnel records.
- We concur with the second matter. Because of workload and time constraints, pre-approval of overtime in the past was informal and documented only after the fact. All overtime hours are now formally pre-approved effective December 2006.

PUBLIC UTILITIES CORPORATION

Schedule of Findings Year Ended September 30, 2006

Local Compliance

Finding 2006-7

Criteria: All investment decisions should be governed by PUC's Investment Policy (Policy). Some of the policies set forth in the Policy are the following:

- It is the policy of the Board to place assets in local certificates of deposit (CDs) issued by local financial institutions with the express purpose of making funds available to the local community in the form of loans. These CDs and the local financial institutions must meet the following criteria on an ongoing basis: (1) Local CDs offer a competitive return relative to alternative issuers; and (2) The local financial institution must provide quarterly financial statements for Investment Committee review. The Investment Committee is charged with monitoring the financial health of the local financial institutions. The Investment Committee will notify the Board for proper action should concerns arise with respect to the financial condition of the local financial institutions.
- The Investment Committee may choose to invest working capital in certificates of deposit offered by minority and/or community financial institutions. These financial institutions must have a minimum capital requirement of at least ten million dollars (\$10,000,000) and meet the reserve requirement set forth in Palau Bank Law. In the absence of specific reserves requirement in the Palau Banking Law, the local financial institution must have a loan to deposit ratio of 75:25.
- No investment manager shall have more than forty percent of the investments under its discretion.

Condition: There is no evidence such as a synopsis of minutes of meetings of the Investment Committee during the year ended September 30, 2006 to indicate that above investment policy was met.

Cause: The cause of the above condition is the lack or inadequate documentation of Investment Committee meetings.

Effect: The effect of the above condition is noncompliance with the investment policy.

Recommendation: We recommend that the Investment Committee meet regularly and ensure that investments are made in compliance with PUC's Investment Policy.

Prior Year Status: Inadequate documentation on Investment Committee meetings was reported as a finding in the audit of PUC for fiscal year 2005.

Auditee Response and Corrective Action Plan: We concur with the above finding. The Board Secretary shall be charged with taking minutes at any Committee meetings.