PALAU VISITORS AUTHORITY

INDEPENDENT AUDITORS' REPORTS ON INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2006

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

Board of Directors
Palau Visitors Authority:

We have audited the financial statements of the Palau Visitors Authority (PVA) as of and for the year ended September 30, 2006, and have issued our report thereon dated January 17, 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 PVA'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 assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect PVA'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 (pages 3 through 5) as items 2006-1 through 2006-3.

A material weakness is a 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 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, of the reportable conditions described above, we consider item 2006-2 to be a material weakness. We also noted other matters involving the internal control over financial reporting that we have reported to management in a separate letter dated January 17, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether PVA's financial statements are free of material misstatement, we 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 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 2006-3.

This report is intended solely for the information and use of the Board of Directors, management, federal awarding agencies, pass-through entities, 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 LLC

January 17, 2007

Cash

Finding No. 2006-1

Criteria: Cash in bank balances should be reconciled to the general ledger on a monthly basis.

Condition: A bank reconciliation was not prepared for the ANZ Tokyo Branch account. A difference of $5,024 was noted between the general ledger and bank statement balance at year-end; however, an adjustment was not proposed due to immateriality.

Cause: The cause of the above condition is the lack of bank reconciliation procedures.

Effect: The effect of the above condition is a misstatement of cash.

Recommendation: We recommend that PVA reconcile its cash accounts on a monthly basis.

Prior Year Status: Improper bank reconciliation procedures was reported as a finding in the audits of PVA for fiscal years 2003 through 2005.

Auditee Response and Corrective Action Plan:

- Current practice is that PVA remits monthly payments for amounts reflected in each month-end expense report when received; however, we expense in the general ledger on a 60-day basis. Therefore, we will expense in the general ledger each month-end's expense report when received from PVA-Japan for our review, reconciliation and payment remittance.
- Discussed with the Accountant to conduct monthly bank reconciliations and report status to the Managing Director.
- As recommended by the auditors, PVA will ensure reconciliation of its cash accounts on a monthly basis.

Liabilities

Finding No. 2006-2

Criteria: Liabilities should be recognized when the expense is incurred and related accruals should be reversed upon liquidation.

Condition: PVA recorded various payables, totaling $17,477, that were invalid accruals and/or adjustments. This condition was corrected through a proposed audit adjustment. Additionally, seven expenses of fiscal year 2005 were recorded in fiscal year 2006 (ref #s JE609134, VP6665, TA 40-05, TA 41-05, 57357, 57364 and VP7770). No adjustment was proposed for these misstatements, as the amounts were considered immaterial to the financial statements.

Cause: The cause of the above condition is the improper treatment of liabilities.

Effect: The effect of the above condition is the misstatement of expenses and liabilities and the possibility of duplicate payments.

Recommendation: We recommend that liabilities be recorded when the expense is incurred and that the accounts payable ledger be reconciled on a periodic basis.

Prior Year Status: Improper treatment of liabilities was reported as a finding in the audits of PVA for fiscal years 2004 and 2005.

Auditee Response and Corrective Action Plan:

- The situation is that PVA had outstanding accounts in prior years that were never settled and vendors/suppliers continued to demand payment. After reviewing our records, it was noted that these past years' outstanding accounts remained unpaid; therefore, we settled them using fiscal year 2006 budget and recorded them in fiscal year 2006. Now, that PVA is strictly trying to maintain 30 days to 90 days aging, we hope that it will be an improvement as to avoid repeating this error in the coming years.

- It has been noted and PVA will do its best to ensure that liabilities be recorded when the expense is incurred and that the accounts payable ledger be reconciled on a periodic basis, preferably on a monthly basis.

Local Noncompliance

Finding No. 2006-3

Criteria: Procurement through small purchase procedures should be supported with price quotations from at least three vendors and vendor selection should be based on competitive price, quality, delivery time and other relevant factors. Procurement policy should not conflict with existing Republic of Palau (ROP) regulations.

Condition: PVA's threshold for competitive bidding is $25,000 while ROP's is $10,000. PVA has set a minimum threshold of $5,000 (requiring three quotations) for small purchases while ROP has no minimum threshold for small purchases. We noted one disbursement (VP7922) that qualifies under small purchases that was not supported by price quotations. The disbursement was related to a long-standing contract for which reassessment of cost has not been performed and the reason for continuing with this vendor has not been documented.

Cause: The cause of the above condition is lack of adherence to procurement policies and procedures.

Effect: The effect of the above condition is noncompliance with established procurement policies and regulations.

Recommendation: We recommend that PVA ensure strict adherence with established procurement policies and procedures and ensure that vendor selections are properly supported with complete procurement files. We also recommend that policies adopted be approved by the Attorney General's office to ensure proper compliance with all applicable laws affecting PVA.

Prior Year Status: Lack of adherence to procurement policies and procedures was reported as a finding in the audits of PVA for fiscal years 2004 and 2005.

Auditee Response and Corrective Action Plan:

- Citing for VP7922 - this was payment for PVA's monthly gas consumption from Shell Company as PVA has an established credit facility with Shell Company that is payable on a month-end basis. Such is treated as we would do for monthly utility bills (electricity and telephone). To avoid future citing of this nature, PVA management will propose for approval of PVA's Board of Directors to add a clause in PVA's Financial Manual to make exception to such purchases.

- PVA management will propose to PVA's Board of Directors to make necessary changes to PVA's Finance Manual to reflect PVA's threshold for competitive bidding to be in compliance with ROP's $10,000 threshold.

- PVA will take the necessary steps to adhere to procurement policies and procedures to be in compliance with ROP.

Unresolved Prior Year Comments
Year Ended September 30, 2006

The status of unresolved prior year internal control findings is disclosed within the Schedule of Findings section of this report (pages 3 through 5).