PALAU INTERNATIONAL CORAL REEF CENTER

INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2008

Deloitte.

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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
Palau International Coral Reef Center:

We have audited the financial statements of the Palau International Coral Reef Center (the Center) as of and for the year ended September 30, 2008, and have issued our report thereon dated November 10, 2009. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Center's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Center's financial statements that is more than inconsequential will not be prevented or detected by the Center's internal control. We consider the deficiencies described in the accompanying Schedule of Findings and Responses (pages 3 through 8) to be significant deficiencies in internal control over financial reporting as items 2008-1 through 2008-5.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Center's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe the significant deficiency described in Finding 2008-1 is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Center's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed one instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Responses as item 2008-4.

We noted certain matters that we reported to management of the Center in a separate letter dated November 10, 2009.

The Center's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. We did not audit the Center's responses and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLC

November 10, 2009

Cash

Finding No. 2008-1

Criteria: Bank reconciliations should be performed on a monthly basis, cash receipts should be reconciled to deposit slips on a daily basis, and cash should be deposited in a timely manner.

Condition: Our tests of cash noted the following:

- During the year, an employee embezzled cash receipts of approximately $32,444. This condition occurred when the Center switched from day deposits to night deposits and resulted from the lack of reconciliations of daily cash receipts reports and deposit slips. The Center did not begin reconciling its bank accounts for fiscal year 2008 until February 2009. The embezzled cash is recorded as accounts receivable, which has been offset by an allowance of the same amount, through a proposed audit adjustment. An estimated amount of $42,000 was embezzled in total.

- Cash collected on November 13, 2007 was not deposited. We were not provided a deposit slip for cash sales as of November 13, 2007.

Cause: The cause of the above condition is the untimely preparation of bank reconciliations and improper reconciliation of daily deposits.

Effect: The effect of the above condition is the misappropriation of cash.

Prior Year Status: The untimely preparation of bank reconciliations was reported as a finding in the audit of the Center for fiscal year 2006.

Recommendation: We recommend that cash sales be deposited on a daily basis and deposits be monitored by designated personnel. We also recommend that bank reconciliations be prepared on a timely basis to assist in identifying suspicious cash shortages.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Fabian B. Iyar, Chief Executive Officer

Corrective Action Plan: Yes, untimely bank reconciliations was a finding in FY06. We got better in FY07, but it got worse in FY08. Lack of cash receipts being reconciled to deposit slips on a daily basis led to the embezzlement of sales from the gift shop. As directed by the Board, we are now performing weekly bank reconciliations and cash receipts are being monitored on a daily basis to match deposit slips. There are times that we cannot make daily deposits such as on weekends and holidays, but we are now making every effort to make deposits on a daily basis.

Proposed Completion Date: Started doing this when the Board directive was issued, and we continue to perform weekly bank reconciliations, daily reconciliations of cash receipts to deposit slips, and making daily deposits. There is no completion date since this is an on-going exercise.

Property, Plant and Equipment

Finding No. 2008-2

Criteria: Fixed assets should be identified by a control number or equivalent (e.g. model and serial # of item) in the fixed asset register and on the item itself.

Condition: Our tests of property and equipment noted the following:

- Fixed asset monitoring numbers are not assigned to assets.
- Japan International Cooperation Agency (JICA) contributed items were not itemized in the fixed asset register as follows:

  a. Office equipment acquired on October 1, 2004 for $76,783, with a net book value of $15,356

  b. Lab equipment acquired on October 1, 2004 for $24,757, with a net book value of $4,985

- Furniture and fixtures with description of "AJE 1" acquired September 30, 2005 for $20,519, with a net book value of $8,207, were not itemized in the fixed asset register.

Cause: The cause of the above condition is the lack of fixed asset monitoring.

Effect: The effect of the above condition is potential misappropriation and misstatement of fixed assets.

Recommendation: We recommend that the Center perform periodic inventories of fixed assets, reconcile the results, and further detail the register by assigning identifying numbers for each item.

Prior Year Status: The lack of a fixed asset monitoring system was reported as a finding in the audits of the Center for fiscal years 2005 through 2007.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Fabian B. Iyar, Chief Executive Officer

Corrective Action Plan: Yes, lack of fixed asset monitoring was reported as a finding in FY05 through FY07. We started the tagging system back in FY06. Apparently, we missed some items, so we will complete this process and conduct periodic inventories of fixed assets and subsequent reconciliation of results in the register/master list. I have asked every department to make sure all invoices for procured equipment be forwarded to Angie at accounting and a copy provided to John at Engineering so that they can keep track and make periodic reconciliation of the asset register.

Proposed Completion Date: December 2009

External Financial Reporting

Finding No. 2008-3

Criteria: Without an adequate system to monitor and identify actual expenses incurred to related grants, an entity cannot accurately report on the use of funding. Additionally, grant revenue should be recognized when allowable expenses are incurred.

Condition: Grant revenues recognized differed from expenses charged against grants by $24,269. Management did not consider the difference in grant revenues and related grant expenses to be material to the financial statements and no adjustment was proposed.

Cause: The cause of the above condition is the lack of established policies and procedures in monitoring program expenses and capitalized assets incurred on a per grant basis.

Effect: The effect of the above condition is the potential misstatement of grant revenues.

Recommendation: We recommend that the Center ensure that grant revenues are recognized when the underlying expense is incurred.

Prior Year Status: Not recognizing grant revenues when the related expense is incurred was reported as a finding in the audits of the Center for fiscal years 2005 through 2007.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Fabian B. Iyar, Chief Executive Officer

Corrective Action Plan: We had started monitoring program expenses and capitalized assets on a per grant basis, as well as making sure that grant revenues are recognized when projects were implemented and corresponding expenses incurred. Apparently, we did not do a very good job of it again in FY08. We will conduct a status assessment of all grants and make sure correct charges are applied to respective grants.

Proposed Completion Date: December 2009

Deferred Revenue

Finding No. 2008-4

Criteria: Grant funds received should be used for purposes stipulated in the grant agreement.

Condition: The Center has deferred revenue of $143,484 related to grant funds received, which is in excess of total cash at September 30, 2008, indicating that grant funds received are being used for purposes unrelated to the grant. Significant deferred revenue balances noted are as follows:

Grant Name	Amount
Fund 252: Packard Ecosystem-Based Management	$ 58,550
Fund 352: National Oceanic and Atmospheric Administration	$ 12,836
Fund 906: Spanish	$ 17,848

Cause: The cause of the above condition is the use of grant funds for purposes unrelated to the grant.

Effect: The effect of the above condition is the potential violation of grant terms and conditions.

Recommendation: We recommend that the Center establish policies and procedures to assist in ensuring that grant monies are used for purposes stipulated in the grant agreement and that unexpended grant funds are monitored.

Prior Year Status: The lack of policies and procedures in monitoring the use of grant monies was reported as a finding in the audit of the Center for fiscal year 2007.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Fabian B. Iyar, Chief Executive Officer

Corrective Action Plan: Some grants are multi-year grants, and so when we receive them in advance, they have to be deferred until such time that projects are implemented and corresponding expenses are incurred and revenues recognized. Also, cash on hand fluctuates every month and the year-end balance is most often less than deferred revenues if the multi-year grants are still in their early stages. Due to cash flow shortages, we are forced to use grant money for regular operations, but they all get reimbursed when cash allotments are received. We will assess each grant fund, and formulate policies to make sure that grand funds are truly restricted and can only be used for intended purposes/allowable costs under the respective grants.

Proposed Completion Date: December 2009

Inventory

Finding No. 2008-5

Criteria: An inventory monitoring system should ensure completeness of periodic counts, inventory unit costs should be determined based on the Center's costing method, and inventory prices should be approved by management.

Condition: Tests of inventory noted the following:

- Several gift shop inventory items, amounting to $7,532, had a price mark-up of less than 50% (management's minimum mark-up percentage).
- The Center was not able to provide complete count sheets for ninety-nine (99) "Polo Shirts with PICRC Logo" as noted in the final inventory valuation.
- In the spare parts inventory listing provided by the Center, unit price was not assigned to the following items: one (1) 2' coral blue light, twelve (12) fluorescent bulbs, eighteen (18) 4' fluorescent light and one (1) 25 mm hose.
- The Center was not able to resolve the variance between the year-end inventory count and the final inventory listing for thirty three (33) storyboard T-shirts (item code: CC1) and twenty-four (24) assorted earrings (item code: LS1).
- Different unit costs were assigned to spare parts with similar descriptions and mode/code number. Also, similar items were not consolidated in the final spare part valuation with one unit cost assigned.
- One gift shop inventory item (dolphin paperweight) included in our test counts during the year- end inventory observation was not included in the final inventory listing
- During the year end inventory observation, we noted that count sheets were not pre-numbered, the storeroom had an incomplete count, several items on the floor such as floral mats and youth T-shirts were not documented on the count sheet and a recount of the storeroom inventory was necessary to ensure completeness. Furthermore, a recount of the jewelry section had to be performed twice to ensure an accurate and complete count. There was no evidence that the initial count was verified. Errors were noted after the initial count and the second count.

Cause: The cause of the above condition is the lack of inventory monitoring.

Effect: The effect of the above condition is the potential misappropriation and misstatement of inventory.

Recommendation: We recommend that the Center ensure that timely reconciliation occur to inventory on hand against inventory records. The Center should ensure that invoices are on file to support inventory costing. Further, mark-ups on inventory should be based on the cost per invoice with management's directive. The Center should also ensure that manual inventory count sheets are on file to support the final inventory listing and procedures should be implemented to ensure the completeness of the count at year end.

Finding No. 2008-5, Continued

Prior Year Status: The lack of an inventory monitoring system, unsupported unit costs, and unauthorized inventory prices was reported as a finding in the audits of the Center for fiscal years 2005 through 2007.

Auditee Response and Corrective Action Plan:

Name of Contact Person: Fabian B. Iyar, Chief Executive Officer

Corrective Action Plan: This is a new finding that will be corrected right away. To address instances where mark-ups were less than 50% as directed by management, this applied to old inventory that have been in the gift shop since day one (i.e. storyboards). Other recent items that can't be marked up at 50% are the consumables such as canned goods, drinks, candies, and other snacks. We plan to put up the old items on sale during the first two weeks of September 2009 so that we may reduce old inventory.

In terms of an inventory monitoring system, we will make sure that we perform timely reconciliation of inventory on hand with inventory records, and make sure invoices are available on file to support inventory costing. We will also make sure that physical count sheets are on file to support the final inventory listing and that procedures are implemented to ensure completeness of the count at year end. We will also make sure that staff assigned to conduct the inventory can do it right the first time.

Proposed Completion Date: September 2009

Unresolved Prior Year Comments
Year Ended September 30, 2008

The status of unresolved prior year internal control findings is disclosed within the Schedule of Findings and Responses section of this report (pages 3 through 8).