

PUBLIC UTILITIES CORPORATION  
(A COMPONENT UNIT OF THE REPUBLIC OF PALAU)

INDEPENDENT AUDITORS' REPORT ON  
INTERNAL CONTROL AND ON COMPLIANCE

YEAR ENDED SEPTEMBER 30, 2009

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, 2009, and have issued our report thereon dated March 26, 2010. 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 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 PUC's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of PUC'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 entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiencies described as items 2009-1 through 2009-4 in the accompanying Schedule of Findings and Responses (pages 3 through 9) to be significant deficiencies in internal control over financial reporting.

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 entity'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 that none of the significant deficiencies 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 two instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Responses as items 2009-1 and 2009-5.

We noted certain matters that we reported to management of PUC in a separate letter dated March 26, 2010.

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

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

  
March 26, 2010

PUBLIC UTILITIES CORPORATION

Schedule of Findings and Responses  
Year Ended September 30, 2009

Procurement

Finding No. 2009-1

Criteria: Pursuant to PUC Procurement Regulations and Procedures, written price quotations must be obtained from at least three vendors for all purchases between \$1,000 and \$25,000. All procurements other than emergency procurements shall issue a public notice by (1) placing advertisements in at least one local newspaper of general circulation; (2) posting at Palau Post Office, Palau Supreme Court building, and any other place deemed appropriate; and (3) announcing the invitation for bids on at least one radio or one television station within the Republic at least once a day for seven consecutive days. Further, all contracts must contain the minimum clauses as enumerated in the procurement regulations. Any allowable exceptions must be properly documented and approved in accordance with applicable PUC Procurement Regulations and such approvals shall be documented in the procurement file.

Condition: Our tests of fixed assets and construction in progress noted the following:

- a. For one construction in progress contract procured through competitive bidding (RFP No. PUC09-194), there was no evidence that the request for bid or public notice was advertised in at least one local newspaper of general circulation.
- b. For one contract relating to rehabilitation of a generator unit (APP Unit 2), significant contract cost changes were made without evidence that such changes were approved prior to incurrence, such as through change orders. Total costs incurred amounted to \$720,387 while the contract cost was \$566,208, the difference of \$154,179 representing contract cost changes.

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

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

Recommendation: We recommend that PUC strengthen controls over procurement and demonstrate 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.

Prior Year Status: Weak controls over procurement regulations and procedures were reported as a finding in the audit of PUC in 2008.

Auditee Response and Corrective Action Plan: PPUC issued a total of twenty-one (21) Requests For Proposals (RFPs) during FY2009. All of these were published in the local newspaper except evidence for this particular RFP cannot be located. PPUC has hired a new Contract Officer who will be in charge of ensuring compliance with the PPUC Procurement Regulation.

Pielstick Unit 2

Service contract cost	\$ 149,000
Parts to be provided by contractor per contract	417,208
Costs incurred prior to contract execution	20,168
Additional costs discovered by contractor after unit was disassembled	124,830
Capitalized interest	<u>9,181</u>
Total costs	<u>\$ 720,387</u>

PUBLIC UTILITIES CORPORATION

Schedule of Findings and Responses  
Year Ended September 30, 2009

Finding No. 2009-1, Continued

The costs incurred prior to contract execution resulted from a seizure and breakdown of a generator unit due to delayed maintenance. Board and management decided to engage a contractor to rehabilitate the unit since it was down.

Additional costs were discovered by the contractor after the unit was disassembled. It was at this time that PPUC was critically short of power capacity with Mitsubishi 12 down at the same time. In light of the emergency and the need to resurrect Unit 2, these additional parts were procured. The PPUC Board of Directors was kept abreast of rehabilitation progress.

All costs associated with the rehabilitation projects were incurred with the foreknowledge of the PUC Board of Directors.

The newly hired Contract Officer shall ensure future projects comply in all aspects with the PUC procurement policy.

Name of Contact Person: Ms. Bouveau Anastacio, Contract Officer

Proposed Completion Date: March 2010

PUBLIC UTILITIES CORPORATION

Schedule of Findings and Responses  
Year Ended September 30, 2009

Expenses

Finding 2009-2

**Criteria:** Expenses should be authorized, supported and approved prior to incurrence. Further, expenses should be recorded in the proper period.

**Conditions:** Our examination of operating expenses indicated the following:

- a. For nine items tested related to inventory adjustments, documentation to support that inventory items issued were used in operations were inadequate. Details are as follows:

<u>No.</u>	<u>GL Acct No.</u>	<u>GL Date</u>	<u>Transaction Source</u>	<u>Source Document</u>	<u>GL Amount</u>	<u>GL Description</u>
1	301-7160-121	9/30/2009	GLTRX6423	IVPHY	\$ 5,110	INV - PDD 09A
2	403-7160-112	9/30/2009	GLTRX6421	IVPHY	59,960	INV - MPP09
3	403-7160-112	9/30/2009	GLTRX6421	IVPHY	7,152	INV - MPP09
4	403-7160-112	9/30/2009	GLTRX6421	IVPHY	82,434	INV - MPP09
5	403-7160-112	9/30/2009	GLTRX6421	IVPHY	50,364	INV - MPP09
6	403-7160-112	9/30/2009	GLTRX6421	IVPHY	51,990	INV - MPP09
7	403-7160-112	9/30/2009	GLTRX6421	IVPHY	12,600	INV - MPP09
8	403-7160-112	9/30/2009	GLTRX6421	IVPHY	44,100	INV - MPP09
9	404-7160-112	9/30/2009	GLTRX6421	IVPHY	<u>20,000</u>	INV - APP-PHY
					<u>\$ 333,710</u>	

- b. One item (Invoice No. 7668) amounting to \$72,958 representing professional services received in 2008 was recorded in 2009.

**Cause:** The cause of the above conditions is weak internal control procedures over operating expenses.

**Effect:** The effect of the above condition is a possibility of unauthorized inventory issuances and misstatements of inventory and operating expenses.

**Recommendation:** We recommend that adequate documentation be maintained to support the issuance of inventory. We further recommend that expenses are recorded in the proper period.

**Auditee Response and Corrective Action Plan:** PUC concurs with item (a) above. The Malakal Power Plant hired an inventory clerk last year but the employee stayed only one month. The position was re-advertised and was only filled in October 2009, after the current fiscal year end. The vacant position made enforcement of internal controls over plant inventory difficult. At the same time, PUC continued to experience mechanical emergencies with unanticipated damages to generator units in Malakal. During these times of emergency, procedures may have been compromised resulting in the above undocumented issuances. The newly hired inventory clerk, under the direct supervision of the plant superintendent, is tasked with ensuring proper documentation of all issuances and movement of inventory at the plant.

**Name of Contact Person:** Mr. Jack Ngiraked, MPP Superintendent

**Proposed Completion Date:** January 2010

PUBLIC UTILITIES CORPORATION

Schedule of Findings and Responses  
Year Ended September 30, 2009

Inventory

Finding 2009-3

Criteria: Adequate inventory controls include accountability of inventory received, issued and in stock during the year.

Conditions: Our examination of inventory additions or purchases indicated the following:

- a. Three inventory additions tested pertain to adjustments to record remaining inventory items based on the year-end physical inventory count. The adjustments were due to inventory items returned but were not supported by completed inventory return forms. Details follow:

<u>No.</u>	<u>GL Acct No.</u>	<u>GL Date</u>	<u>Transaction Source</u>	<u>Source Document</u>	<u>GL Amount</u>	<u>GL Description</u>
1	1331000	9/30/2009	GLTRX6421	IVPHY	\$ 12,440	INV - MPP09
2	1331000	9/30/2009	GLTRX6421	IVPHY	71,550	INV - MPP09
3	1331000	9/30/2009	GLTRX6421	IVPHY	<u>9,975</u>	INV - MPP09
					<u>\$ 93,965</u>	

- b. For one inventory purchase (Transaction Source No. GLTRX6069), there was no supporting documentation provided relating to a cost adjustment amounting to \$58,948.

Cause: The cause of the above conditions is inadequate compliance with controls over inventory.

Effect: The effect of the above condition is potential misstatement in inventory balances.

Recommendation: We recommend that PUC strengthen inventory controls.

Prior Year Status: Weak controls over inventory issuances were reported as a finding in the audits of PUC in 2008 and 2007.

Auditee Response and Corrective Action Plan: PUC concurs with item (a) above. The Malakal Power Plant hired an inventory clerk last year but the employee stayed only one month. The position was re-advertised and was only filled in October 2009, after the current fiscal year end. The vacant position made enforcement of internal controls over plant inventory difficult. At the same time, PUC continued to experience mechanical emergencies with unanticipated damages to generator units in Malakal. During these times of emergency, procedures may have been compromised resulting in the above undocumented issuances.

The newly hired inventory clerk, under the direct supervision of the plant superintendent, is tasked with ensuring proper documentation of all issuances and movement of inventory at the plant.

Item (b) above was a returned item to inventory. It appears that documentation relating to this cannot be found and we can only surmise that it may had been lost during the move to the new office.

Name of Contact Person: Mr. Jack Ngiraked, MPP Superintendent

Proposed Completion Date: January 2010

PUBLIC UTILITIES CORPORATION

Schedule of Findings and Responses  
Year Ended September 30, 2009

Inventory

Finding 2009-4

Condition: Inventory count procedures should be strictly applied to facilitate an accurate inventory count. Further, variances between the general ledger and the subsidiary ledger should be investigated and reconciled in a timely manner.

Criteria: We observed the Malakal Power Plant inventory count on September 30, 2009 and the following were noted:

- a. Items contained in sealed wooden boxes were found in the open area by the generators without knowledge that they should be counted as part of inventory.
- b. Five boxes located in the parts room for the Peleliu Plant were not counted.
- c. There was an emergency issue during the inventory count without the knowledge of the staff performing the count and no issuance form or equivalent documented the issuance.
- d. Boxes of parts were located in the workshop room and were not counted.
- e. Count sheet no. 6 did not have a date and initial of the person verifying and one item had no part number.
- f. Five items test counted by the auditor did not agree to count sheets with variances between one and three items.
- g. Count sheet no. 37 listed four items but without part numbers, making entry of the items in the system more difficult.

A recount of the inventory was necessary to ensure an accurate count.

Further, variances were noted in quantities between year-end inventory test counts and the final inventory valuation report. Details follow:

<u>No.</u>	<u>Stock No.</u>	<u>Description</u>	<u>Agreed Count</u>	<u>Qty.</u>	<u>Per Final Inventory Valuation Report</u>		<u>Difference</u>		
					<u>Unit Cost</u>	<u>Unit</u>	<u>Cost</u>		
1	8017-401	Piston Complete	3	0	\$ 29,980	3	\$	89,940	
2	213-003	Gasket	12	21	\$ 475	(9)		(4,275)	
3	205-001	Cylinder Liner	1	0	\$ 12,950	1		12,950	
4	207-1551	Starter	1	0	\$ 2,100	1		2,100	
5	none	Fuel Injection Pump	11	0	\$ 2,598	11		28,574	
									<u>\$ 129,289</u>

Cause: The cause of the above conditions is due to weak internal control procedures related to physical inventory counts. It appears that the August 13, 2009 memorandum regarding inventory count procedures from the Chief Financial Officer was not strictly followed by the Malakal Power Plant.

Effect: The effect of the above conditions is the potential for misstatement of inventory.



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Schedule of Findings and Responses  
Year Ended September 30, 2009

Finding 2009-4, Continued

Recommendation: We recommend that inventory count procedures be followed and personnel performing inventory counts be adequately supervised. We further recommend that inventories be properly valued and reconciled with physical counts on a timely basis.

Auditee Response and Corrective Action Plan: PPUC concurs with the above finding. The procurement clerk who was responsible for inventory counts at this location failed to follow instructions. Future inventory physical verification processes shall be monitored to ensure compliance with established procedures, which include a physical organization of inventory items at the site to facilitate counts.

Name of Contact Person: Ms. Jacqueline Alexander, CFO/Ms. Bouveau Anastacio, Contract Officer

Proposed Completion Date: March 2010

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Year Ended September 30, 2009

Local Compliance

Finding 2009-5

Criteria: The Palau National Code (PNC) Chapter 37 Section 302 states that all entities of the national government and the state governments shall pay for all electrical and water utility services consumed, and shall not be given preferential treatment in the handling of their accounts by the agency of the national government responsible for the collection of such utility charges.

Condition: As of September 30, 2009, utility receivables from the national government and the state governments amounted to \$2,856,020 of which \$1,469,102 or 51% is over ninety days.

Cause: The cause of the above condition is that management is reluctant to disconnect government accounts as it may disrupt public services.

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

Recommendation: We recommend that PUC comply with the provisions of the PNC.

Prior Year Status: Noncompliance with PNC Chapter 37 Section 302 was reported as a finding in the audit of PUC for fiscal years 2008 and 2007.

Auditee Response and Corrective Action Plan: PUC concurs with the above finding. PUC has been converting the national government single-phase power connections to prepaid metering. This will eliminate the possibility of future arrears accruing.

There are certain government accounts that, if disconnected, pose serious threat to public and personal health such as the hospital, airport, and sewer pumps. These accounts tend to accrue (57% of total ROP receivables at September 30, 2009) and PUC is seeking appropriate means to address the matter.

Name of Contact Person: Ms. Ruth Wong, Business Office Manager

Proposed Completion Date: September 2010

PUBLIC UTILITIES CORPORATION

Unresolved Prior Year Findings  
Year Ended September 30, 2009

The status of unresolved prior year findings are disclosed within the Schedule of Findings and Responses section of this report (pages 3 through 9).