

# Performance Audit on the Assistance to Agricultural Development in Lelu Town, Kosrae

A Report to the  
Governor  
and the  
Legislature of  
the State of Kosrae



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PUBLIC AUDITOR



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May 05, 2016

The Honorable Governor, Lyndon H. Jackson  
The Honorable Speaker, Tulensa W. Palik  
The Honorable Members, 11<sup>th</sup> Kosrae State Legislature  
Kosrae State Government  
Kosrae State, Federated States of Micronesia 96944

**Re: Performance Audit on the Assistance to Agricultural Development in Lelu Town, Kosrae**

**EXECUTIVE SUMMARY**

We respectfully submit this Performance Audit PA 02-2016 as a result for our review on the Assistance for Agricultural Development in Lelu Town, Kosrae covering the period of FY 2009-2010. The project is to Provide for Assistance to Agricultural Development in Lelu Town, Kosrae Stae by the Embassy of Japan in the Federated States of Micronesia.

The objective of the audit was to determine whether (1) The procurement and payment of equipment and supplies is in accordance with the grant requirements and applicable laws; (2) Safeguard the equipment and supplies against loss and misuse; and (3) Equipment and supplies are being used in accordance with the grant agreement.

The audit was performed in accordance with auditing standards generally acceptable in the United States of America and the standards applicable to performance audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. The audit was also conducted pursuant to Title 10 Chapter 4 of the Kosrae State Code. Furthermore, Kosrae Financial Management Regulation, Lelu Town Financial Act and the Grant Agreement were use as criteria for compliance.

With reference to the specific objectives we noted the following:

- (1) Procurement process does not conform with the enabling laws, regulation, resolutions and grant agreement
  - a. Misused of Grant proceed was cited for the following:
    1. Misused of \$11,500.00 for dump track using falsified receipt

2. Purchase of appliances and furniture for school which does not exist amounting to \$1,591.63
  - b. Appropriation of the Lelu Town Council (CB. No: 07-09) for US\$ 72,780.42 does not match to the total grant of U\$ 97,087.00
  - c. No procurement bidding was made in accordance with the Financial Management Regulation.
- (2) There is insufficient records of assets maintenance and safeguarding procedures; and
  - (3) Equipment and supplies are being used in accordance with grant agreement.

Based on the foregoing findings, we recommend (1) that Lelu Town Government (LTG) take action to establish the accountability of the personnel involved in implementation of the grant agreement especially on the questionable transaction as mention in Finding 1; (2) that LTG should follow Kosrae Financial Management Regulation and Lelu Town Financial Act in managing grant proceeds and fiscal management; and (3) that LTG should develop Maintenance Manual Checklist.

Details of our examination are discussed in the findings and recommendations section of this report.

The Office of the Public Auditor provided draft copies of this report with the administration of Lelu Town Government for review and comment on April 12, 2016. The contents were discussed with Administration of Lelu Town Government and were given 10 working days to respond. Management response was received on May 05, 2016 attached as appendix 3 of this report.

Respectfully submitted,

  
Stoney S. Taulung  
Public Auditor

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## INTRODUCTION

The Project is to Provide for Assistance to Agricultural Development in Lelu Town, Kosrae State by the Embassy of Japan in the FSM. The project implementation is in Lelu Town, Kosrae State. The implementing agency is Lelu Town Government, Kosrae State to complete the Project within one year after the contract date which is June 24, 2009.

The aim of the project is to establish farming schemes at the grassroots level to support both subsistence and economic cash crops for the livelihood of the community. Both financial support and supplies were rendered to move and sustain the project. With the view to contribute to the execution of the project by Lelu Town Government, Kosrae State (referred as the recipient), entitled the Project for Assistance to Agricultural Development in Lelu Town, Kosrae State” (referred as the Project), the Embassy of Japan in the Federated States of Micronesia (referred as the donor) will make available to the recipient a grant up to Ninety-seven thousand Eighty-seven Dollar (US\$97,087.00) by March 31, 2010 which proceeds were spent for the following:

Particular	Amount
Greenhouse (33x10 feet)	\$ 3,398.06
Waterline construction for nursery	\$ 1,456.31
Secondhand container (20 ft)	\$ 2,427.00
Backhoe	\$ 18,279.57
Green machine, tip saw	\$ 1,756.99
Tractor, tiller, chipper and parts	\$ 19,295.69
Text book	\$ 1,080.91
Other various equipment	\$ 6,419.54
Freight container services	\$ 9,037.90
Electrical appliances	\$ 1,591.63
Water purifier	\$ 1,578.90
Wharfage and Drayage	\$ 489.46
Dump truck (second hand)	\$ 11,500.00
Agricultural materials	\$ 749.95
Mini Excavator	\$ 13,755.00
Wharfage and Drayage	\$ 15.91
Stevedoring	\$ 52.00
Customs and Taxes	\$ 547.20
Recycled battery	\$ 4.00
Agri-tools	\$ 3,154.17
<b>Total Purchases</b>	<b>\$ 96,590.19</b>
<b>less Total Grant</b>	<b>\$ 97,087.00</b>
<b>Difference</b>	<b>\$ (496.81)</b>

The terms of reference of this project are set in the Grant Contract between the Embassy of Japan in the Federated States of Micronesia and Lelu Town Government, Kosrae State. The Grant Agreement provides detailed provisions that serve as the recipient's guidelines in the execution of this project.

## **AUDIT OBJECTIVE AND SCOPE**

### **Objectives**

The purpose of this audit is to determine whether:

- (1) The procurement and payment of equipment and supplies is in accordance with the grant requirements and applicable laws;
- (2) Safeguard the equipment and supplies against loss and misuse.
- (3) Equipment and supplies are being used in accordance with the grant agreement;

### **Scope**

Our performance audit covered the Project for Assistance to Agricultural Development in Lelu Town, Kosrae State covering FY 2009 - 2010. However, the gathering, reviewing and testing of relevant information and documentations included previous and subsequent period for analytical purposes. We conducted the inspections pursuant to Kosrae State Code Title 10, section 4 which stated in part:

“(a) The Public Auditor shall inspect and audit personally, or by his duly authorized assistants, all account, books, and other financial records of the State Government, to include but not be limited to, every branch, department, office, political subdivision, board, commission, agency, other public legal entity (owned, or partially owned by the state), whether they receive public funds or not, and nonprofit organizations that received public funds from the State Government;

(b) Inspect and audit personally, or by his duly authorized assistants, the fiscal books, records and accounts of all allottees and other custodians of public funds, making independent verification of all assets, liabilities, revenues, expenditures and obligations of the State Government, entities owned in whole or part by the State Government, and agencies of the State Government;

(c) Inspect and audit personally, or by his duly authorized assistant, the fiscal books, records, and other financial records associated with any project, program and activity receiving

funding in whole or in part from public funds of the State Government, including the records of any contractor performing public work on a cost-reimbursement-type contract in order to verify the cost charged to the public contractor;

(d) Inspect and audit personally or by his duly authorized assistants, the books, records, accounts, and other financial records associated with business sales that may be used for sales assessment for tax collection purposes”

## **AUDIT METHODOLOGY**

The audit was conducted in accordance with generally accepted government auditing standard (GAGAS). Those standards requires that we plan and perform the audit to obtain, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In planning our examination, we obtained sufficient understanding of the internal controls that is material to the audit objectives to plan the engagement and design the audit procedures. Based on this assessment, we reviewed documents and records relevant to the Project.

We considered compliance to state laws and regulations and to the Grant agreement to be able to render an opinion to our audit objectives. Our procedures were also designed to identify weaknesses on internal controls that are material to the expression of an opinion to our audit objectives.

Audit procedures included, but were not limited to, interviews of Lelu Town Mayor and employees and review of transaction process and documentation. We also perform analytical review of disbursement and safety & maintenance procedure of fixed asset. The audit criteria used to develop the required audit tests were based on (1) the Financial Management Regulation and (2) Grant Agreement provisions.

## **PRIOR YEAR AUDITS/REVIEWS**

This is the first time that a separate audit / examination was conducted on Project for Assistance to Agricultural Development in Lelu Town, Kosrae State.

## **CONCLUSION**

We concluded that based on the audit objectives the equipment and supplies were:

- (1) Procurement process does not conform with enabling laws, regulations, resolutions and grant agreement;
  - a. Misused of Grant proceeds was cited for the following:
    1. Misused of \$11,500.00 for dump truck using falsified receipts
    2. Purchase of appliances and furniture for school which does not exist amounting to \$1,591.63.
  - b. Appropriation of the Lelu Town Council ( C.B. no: 07-09) for US\$ 72,780.42 does not match to the total grant of US\$ 97,087.00
  - c. No procurement bidding was made in accordance with the Kosrae Financial Management Regulation.
  - d. No record has been kept by the Lelu Town Government Administration for the above mention project.
- (2) There is insufficient record of Assets Maintenance and Safeguarding Procedures.
- (3) Equipment and supplies are being used in accordance with the grant agreement.

## **FINDINGS AND RECOMMENDATIONS:**

### **1) Procurement process does not conform with enabling laws, regulations, resolutions and grant agreement**

The audit found that the proceeds from the Grant amounting to US\$ 97,087.00 were spent in accordance with the Grant Agreement for the Project for Assistance to Agricultural Development in Lelu Town, Kosrae. These are based on our review of the documents submitted to us by the embassy of Japan in FSM since documents for the above project were not available at the Town Municipal office. The audit summarized the details of the project disbursement as follows (see appendix)

**1. a) Misused of Grant proceeds:**

**1.a.1) Falsified receipt of US\$ 11,500.00 for the purchase of dump truck**

The auditor's review and verification of receipts submitted for project closing report by the Lelu Town Government reveal that receipt no. 7843 from Four Stars Company a dealer of heavy equipment in Kosrae State was falsified (see appendix 1). We have conducted interviews and confirmation of receipt and delivery details with the supplier and other personnel that may have knowledge in the transaction, however, neither of them acknowledges the authenticity of the transaction.

**1.a.2) Purchase of appliances and furniture for school which does not exist amounting to US\$ 1,591.63.**

Further review of receipts for the project reveals that \$1,591.63 paid to Shop Nao CO. Ltd. for various equipments and furnitures (see appendix 2) apparently for the agricultural school/dormitory for Lelu Town Government. Those equipments and furnitures were not accounted and were not booked as assets by the recipient. It was also noted that there was no record of existence of any agricultural school in Lelu Town.

**1.b) US\$ 24,306.58 of the grant total amount was not appropriated by the Lelu Town Council**

Review of the Lelu Town Council resolution C.B. No; 07-69 (LTO: 07-65) the council enacted and appropriated the sum of US\$ 72,780.42 from the Capital Improvement Account of the Lelu Town Government treasury for funding the procurement of imported merchandise from Japan to Kosrae to fulfill the project from the Japan Grass Root Assistance Fund. The auditor confirms that no further resolution was made for the remaining US\$ 24,306.58 which is the difference of the total grant and the resolution made. Subsequent purchases of equipment and other payments were not appropriated by the council.

Public money raised or received by the LTG shall be deposited within the Lelu Town Government Treasury. **No money shall be withdrawn from the LTG Treasury except in accordance with appropriations or authorizations by law.**

**1.c) No procurement bidding was made in accordance with the KFMR.**

The auditor noted that there is no documentation indicating bidding process in procuring all the equipment and construction of greenhouse. In addition, there was no justification and

certification for “Sole Source Purchase”. Whereas, the Kosrae State Financial Management Regulation requires a written report, containing price quotations for the item(s) to be purchased or leased from at least two vendors, and an explanation of the reasons why a particular vendor was selected shall be required before the letting of any Government Agency of any and all contracts for the purchase of Personal Property or supplies.

**1.d) No record has been kept by the Lelu Administration for the above mention project.**

It was also noted by the auditor that the Lelu Town Municipal office did not properly reconcile records and documents of procurement process related to the project.

The KFMR states that allottee is required to keep records and documents for audit at all times. It is also specified in the grant agreement that the recipient should keep accounting documents that verify how the grant was spent for at least five years after the completion of the Project. While the grant agreement (item G.) requires the recipient to keep accounting documents that verify how the grant was spent for at least 1 year after completion of the Project. As per record the project was completed July 2015.

**Cause:** We noted that minimal effort from the recipient to ensure that the procuring process and grant proceeds management provided in Lelu Town Financial Management Act and Kosrae State Financial Management Regulation are being followed.

**Effect:** The procuring process does not substantiate maximization of cost and proper usage of fund/ grant proceeds. Possibility of fraud is high.

**Recommendation:**

We recommend that the Lelu Town Government takes action to establish the accountability of the personnel involved in implementation of the grant agreement especially on the questionable transaction as mention in finding 1.a. In addition, LTG should follow the procurement process in accordance with the Kosrae State Financial Management Regulation to ensure fair and effective use of government fund as well as grant proceeds. Thus, LTG should keep records and documents pertaining to all the funds and grant to strengthen internal control on accountability.

**(2) There is insufficient record of Assets Maintenance and Safeguarding Procedures.**

Based on the interview and inquiries with responsible personnel from the Lelu Town Governments, the auditors noted that there is insufficient internal control in place to ensure adequate safeguarding on the equipments and supplies against damages. We were informed that there is a schedule for equipment operation that includes cleaning and refilling of fuel but no regular preventive maintenance schedule is in place. The Project Completion Report mainly states on the operational cost of the equipment but does not specified how the department will safeguard and maintain the equipment for longer useful life.

**Cause:** There appeared to be minimal consideration on fixed assets preventive maintenance.

**Effect:** Lack of preventive maintenance could cause early machine wear off that could shorten the equipment useful life.

### **Recommendation**

We recommend that the Lelu Town Government should develop Maintenance Manual Checklist. This is to monitor repairs and maintenance for all the equipment to avoid equipment breakdown and higher operational cost in the future.

### **(3) Equipment and supplies are being used in accordance with the grant agreement;**

The auditors confirm that the equipment and supplies accept those where mention in finding# 1 were used in accordance to the grant agreement and was able to provide supplies and services to the farmers.



**Appendix 2: Receipt for Equipment and Furniture purchase for Agricultural School**

Mr. Widmer M. Sigrav  
Mayor, Lelu Town Govmt  
Lelu, Kosrae, FSM 96944

August. 3. 2009

Shop Nao CO. LTD  
2-2-1 Shimura, Itabasi Tokyo Japan  
Tel: (03) 5915-9088

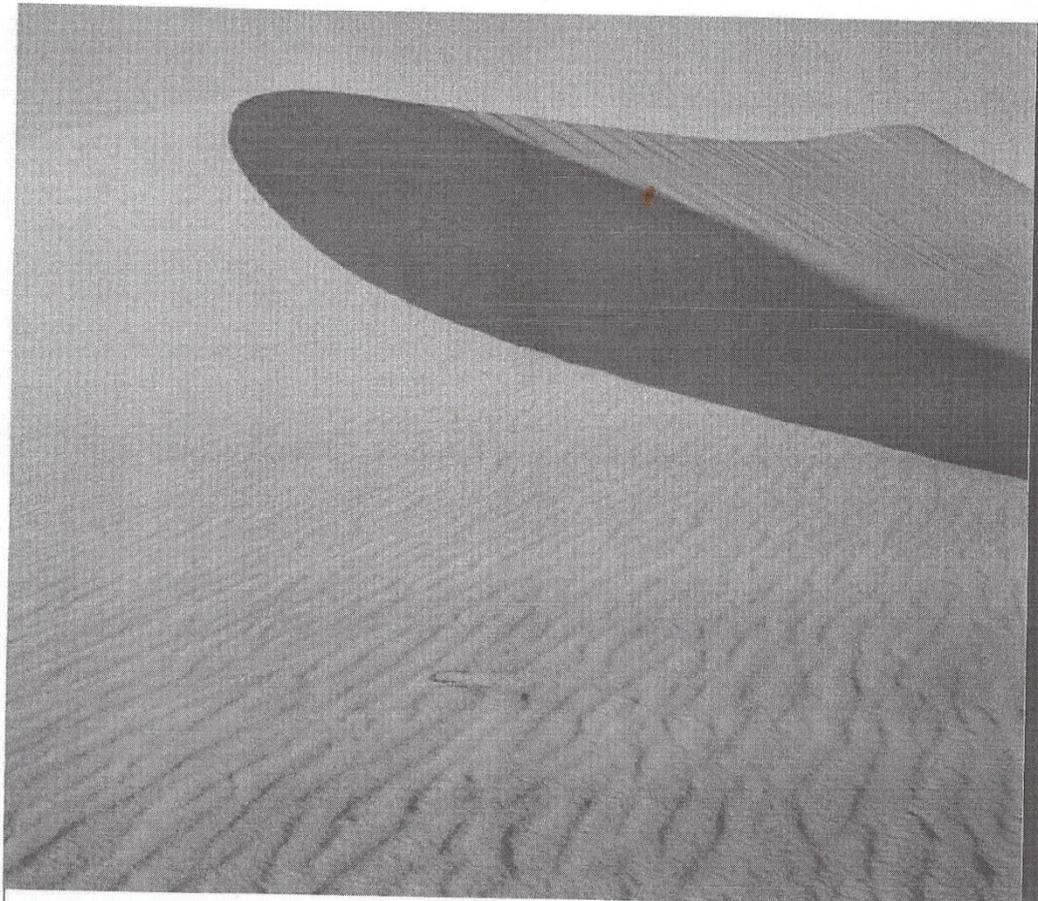
PAYMENT RECEIPT

	Equipment name	Unit	Unit Price		Total		Number
			(USD)	(yen)	(USD)	(yen)	
1	Refrigerator	2	194.00	20000	388.00	40000	
2	Fan	4	19.40	2000	77.60	8000	
3	TV screen	1	242.72	25000	242.72	25000	
4	DVD player	1	67.96	7000	67.96	7000	
5	Shelf	3	77.67	8000	233.01	24000	
6	Cooking heater	2	77.67	8000	155.34	16000	
7	Bed	2	116.50	12000	233.00	24000	
8	Home appliance	1	194.00	20000	194.00	20000	
TOTAL					1591.63	164000	
					Discount	12796	
						151204	yen

Exchange rate = 95 Yen / USD

*agricultural school (please identify)*

Appendix 3: LTG Management Response



## **LELU TOWN GOVERNMENT**

### **REACTION TO AUDIT REPORT**

This report, in response to, is mainly the reaction of Lelu Town Government (LTG) to the Audit findings against the Project for Assistance to Agriculture Development of Lelu Town Government through the Government of Japan.

# **LELU TOWN GOVERNMENT**

## **REACTION TO AUDIT REPORT**

### **I. INTRODUCTION**

The purpose herein is to react to the audit findings against the Project for Assistance to Agriculture Development for Lelu Town Government. This Project was established in 2009 between Lelu Town Government and the Government of Japan. It was intended for a year duration, but for some unknown reasons it went beyond the proposed period due to poor management, including inappropriate used of funds, thus called for immediate closure of the account and be audited at the request of Japan Government

Lelu Town Government commented on such citations outlined in the draft report filed by Kosrae Office of Public Auditor (KOPA)). Although tedious, a superlative job had been performed.

As such, specific to the audit findings of which Lelu Town Government has been cited for the following comments are being filed.

### **II. Findings and Comments**

#### **1. Procurement process does not conform with enabling laws, regulations, resolutions and grant management.**

This may be true, but there are in existence enabling laws or regulations in the LTG's Manual of Rules and Procedures. Lelu Town Government is a local government in its own right to enact ordinances in safe-guarding financial embezzlements. If such finding is true, then it was a management problem.

##### **1.a. Misused of Grant proceeds**

###### **1.a.1) Falsified Receipt of US\$11,500.00 for the purchase of a dump truck**

Whether it is being falsified or not, a Receipt was documented to indicate a business transaction had been reached. With this Receipt it had halted the reimbursement payments the new administration put in motion.

During the changed of administration in 2013, the new administration noted an inoperable dump truck within the LTC's Compound. Up until September 2015, the dump truck was surveyed and scrapped. It might or might not be the dump-truck.



**1.a.2) Purchase of appliances and furniture for school which does not exist amounting to US\$1,591.63.**

Lelu Town Government, meaning the succeeding administration has not aware of such procurement and could not verify the purchases as most involved had left the Office and even the island. Thus, no consultation nor follow-up were done. In this respect "no further comment", but will consult with the officials at Lelu Elementary School.

**1.b.) US\$24,306.56 of the grant total amount was not appropriated by Lelu Town Council.**

As to why no appropriation was made for the remaining funds indicated has not been clearly defined. However, it is believed that this amount was included in the total amount of US\$28,207.27, Lelu Town Government was instructed to reimburse. In fact, Lelu Town Government had taken counter measure steps to rectify the unaccounted amount and plus until advised to stop for the fact that the requirement was met.

Thus, if this amount is part of the unaccounted funds, then Lelu Town government had taken corrective measures for the reimbursement.

**1.c) No procurement bidding was made in accordance with the KFMR.**

This may be possible, but in as much as not very many vendors and/or contractors on the island had minimized the opportunity for biddings. Sole Source was utilized.

LTG has its own Financial Management Regulations, through legislative processes through bills, ordinances then appropriations for operational accounts. For the grassroot account there is a Saving Account #6011099238 with the Bank of Federated States of Micronesia. This Bank Account is mainly for the reimbursement amount.

Corrective steps have been established to control disbursement of public funds from LTG's Treasury.

**1.d). No record has been kept for the Lelu Administration for the above mentioned project.**

This is also may be true for insufficiency of record keeping or documentation of procurement processes involved. During the interim, however, periodic monitoring were conducted by staff from Japan Embassy, Federated states of Micronesia of which noted and cited some of these irregularities.

The current administrator/mayor was not the allottee of the grant funds to stay abreast of all transactions against the account.

The recommendations provided are well taken and highly being considered for improvements.

**(2) There is insufficient record or Assets Maintenance and safeguarding Procedures.**

- No comments to this finding. It is true that some of these equipment are unaccounted for and many are broken down (green machines, diller, etc.) Some were sold, but no sales slips or receipts are kept for verification (e.g. green houses, water hoses, etc.
- Preventive Maintenance is a priority for the new administration on all equipment. It may be true for the passed administration which handled the grant funds.
- Some of the broken down equipment were replaced (e.g. mini-excavator, dump truck) with LTG's and Project's funds.
- LTG will continue to work toward the recommendation for developing Maintenance Manual Checklist for sustainment of equipment and tools alike.

**III. Conclusion:**

The draft report has been reviewed and acknowledged for its appropriateness. Lelu Town Government has endorsed such findings and wishes to express sincere appreciation to the Government of Japan for such assistance, but highly apologize for breaching the grant agreement, monetary-wise. It is with great regret that the Government of Japan will not accept these fact findings, but still, Lelu Town Government hereby seeks to be pardoned as the current administration has done its best to correct most issues inherited.

**IV. Acknowledgement:**

This is to further express sincere gratitude to Kosrae Office of the Public Auditor (KOPA) for the tiresome undertaking in the production of such excellent report in clarifying, if not all, to most of the uncertainties or questions costs associated with grant management received from Japan.

Respectfully submitted,



Jesse, B.  
Mayor, LTG

## **Public Auditor's Comments**

We would like to extend our appreciation to the Lelu Town Government Mayor and Councilmen for their cooperation and assistance throughout the course of our audit.

In compliance with Generally Accepted Government Auditing Standards, a copy for the draft report was shared with the Lelu Town Government with a management response. The response is attached which agreed on most of the findings and recommendations.

In addition to provide a copy to Lelu Town Government, we also extend copies to the officials and agencies:

1. Governor, Kosrae State Government
2. Speaker, 11<sup>th</sup> KSL and all members
3. Chief Clerk, Kosrae State Court
4. V6AJ Radio

If there are any questions or concerns regarding this report, please feel free to contact the Office of the Public Auditor.

  
Stoney S. Taulung  
Public Auditor

**ACKNOWLEDGEMENT AND OPA CONTACT**

**Performance Audit on Project for Assistance to Agricultural Development of Lelu Town  
Government**

**Report No. PA 02-2016**

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**ACKNOWLEDGEMENT**      Emma Belagot, CPA, Audit Manager  
The audit staff that make key      Alice S. George, Auditor II  
contributions to the report      Merlyn Benjamin, Auditor I

**OPA Mission**      Conduct effective and efficient audits and  
Investigation to ensure that Government resources  
are properly managed.

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