

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES
FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995**

BACKGROUND

Organization and Function

The Pohnpei Port Authority (the Authority) was established by Pohnpei State Public Law 2L-224-91. The primary purpose of the Authority is to oversee the use and maintenance of Pohnpei State's sea and air ports. The Authority began operating as a separate entity in fiscal year 1993 although the accounting for the Authority was not transferred from the Pohnpei State Department of Treasury until January 1994.

The affairs of the Authority are managed by a seven-member board, consisting of representatives of the Pohnpei State Government appointed by the Governor to four-year terms. Daily operation of the Authority is delegated to a General Manager, who is appointed by and serves at the pleasure of the Board.

The Authority is a component unit (a discretely presented proprietary fund) of the Pohnpei State Government. Hence, the accounting policies of the Authority conform to accounting policies generally accepted in the United States of America, as applicable to governmental entities, specifically proprietary funds. Proprietary funds are used by governmental units to account for operations that are financed and operated in a manner similar to private business enterprises. The purpose of a proprietary fund is to provide periodic determination of revenues, expenses and net income, with maintenance of capital.

Sources and Uses of Funds

The Authority's main sources of revenue are from seaport charges, departure fees, landing fees, and land leases and space rentals. The Authority also received grants and funding appropriation for projects. In addition, the Authority also resorts to commercial loan borrowing from banks, in order to finance some of its major improvements.

A detailed statement of the Authority's proposed annual budget is required to be prepared and submitted to the Governor on or before March 15th of each year. The annual budget is adopted upon the Governor's approval. In the event of the Governor's disapproval of the proposed budget, the Authority and the Governor, or their representatives, shall within 10 days after notification by the Governor, meet and discuss the proposed budget in order to reach an agreement. If a satisfactory agreement is not reached within 10 days thereafter, the proposed budget shall be submitted for consideration and decision to a board of arbiters, whose decision shall be final.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES
FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995**

OBJECTIVES OF THE AUDIT

The audit was performed with respect to the following transactions:

1. Time Certificate of Deposit (TCD) accounts with local banks from a FSM National Congress appropriation for the construction of the Kapingamarangi airstrip worth \$300,000.
2. Commercial loan with Bank of FSM worth \$100,000 for the purchase of an airport sweeper.
3. Loan with FSM Development Bank worth \$264,000 for the matching fund for the construction of the new departure area.

The specific objectives of the audit were:

- a. To determine whether funds appropriated or loaned with respect to the above-mentioned transactions are expended in accordance with the intended purpose(s).
- b. To determine the total interest income generated on the above-mentioned TCD's and whether such amount was obligated or expended in accordance with laws and regulations.

SCOPE AND METHODOLOGY

The Authority received the CFMSM appropriation of \$300,000 in September 1995. The \$100,000 loan was received in July 2000, while the other loan of \$264,600 was secured by the Authority in July 1999. Our audit was limited to the review of information and documentation relative to the transactions mentioned above.

To accomplish our audit objectives, we have performed the following procedures:

- Obtained copies of Budget allotment advice and CFMSM project control documents on the \$300,000 Kapingamarangi funding;
- Confirmed balances of Time Certificate of Deposits and Loans with local banks as of September 30, 2001;
- Prepared bank account analysis and calculated interest income generated from the \$300,000 TCDs from September 1995 to September 30, 2001;
- Traced interest income generated from the TCDs to the Authority's cash receipts journal;
- Reviewed documentation of commercial loans amounting to \$100,000 and \$264,600 from two local banks;

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES
FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995**

SCOPE AND METHODOLOGY, continued:

- Reviewed documentary evidence supporting the expenditures and disbursements of loan proceeds;
- Interviewed some of the Authority's personnel;
- Compared budget and actual operating revenues;
- Analyzed the Authority's financial statements and some internal reports.

AUDIT ENGAGEMENT

Government Auditing Standards require that the Office of the Pohnpei State Auditor (OPSA) should have an external quality control review at least once every three- (3) years. The last review was conducted in October 1998. Except for the timeliness of an external quality control review, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the *Government Auditing Standards* issued by the Comptroller General of the United States. The audit was also conducted pursuant to Article 11, Section 8 (2) of the Pohnpei State Constitution, PSL No. 1L-10-79, and at the request of the Honorable Johnny P. David, Governor of Pohnpei State.

PRIOR AUDIT COVERAGE

This is the first audit applying agreed-upon procedures performed on Pohnpei Port Authority by the Office of the Pohnpei State Auditor. An audit to apply agreed-upon procedures is one in which an auditor/accountant is engaged to issue a report of findings based on specific procedures performed on the specific subject matter of specific elements, accounts, or items of a financial statement.

OPSA had performed financial audits of the Authority for the fiscal years 1994 to 1996.

AUDIT CONCLUSION

Our audit was performed not to express an opinion about whether the specified transactions mentioned earlier in the report are fairly stated in accordance with the generally accepted accounting principles. Accordingly, we do not express such an opinion.

As a result of our audit, we have identified three (3) internal and management control weaknesses, which are detailed in the Schedule of Findings and Recommendations, on pages 5 through 11 of our report. Summarized below are our audit findings:

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES
FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995**

AUDIT CONCLUSION, continued:

Objective number one:

1. A fiscal year 1995 CFMSM appropriation amounting to \$300,000 for the construction of Kapingamarangi airstrip was received and invested by the Authority because the project has not started due to some problems.
2. Portion of the loan funds amounting to \$100,000 was used for purpose/s other than the original intent of the loan.

Objective number two:

3. Interest income generated from the 1995 CFMSM appropriation of \$300,000 was deposited to the Authority's general account and appeared to have been used to finance the Authority's operations and capital outlay.

As part of our audit, we also looked into a loan secured by the Authority from a development bank, worth \$264,600. The loan, which is intended for the construction of the airport departure area, was approved by the former Governor upon the request of the Authority's management. The loan was obtained on July 20, 1999 and is due on July 10, 2004. It bears interest of 9% per annum, with monthly amortization of \$5,493. The Authority assigned the proceeds of lease payments of an oil and gas company as collateral for the loan.

Our audit disclosed that drawdowns to the loans were directly disbursed by the development bank to the contractor or supplier, by a letter request from the Authority. We confirmed the balance of the loan not yet disbursed by the bank to be \$84,301.26 as of December 31, 2000.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

Objective number 1:

CFSM appropriation of \$300,000 received and invested by the Authority

1. Criteria:

FSM Public Law no. 9-006 (amending Public Law nos. 6-28, 6-66 and 8-22) appropriated the amount of \$300,000 to the Authority for the construction of the Kapingamarangi airstrip, which also states that: *“The fund shall be allotted, managed, administered, and accounted for in accordance with applicable law, including, but not limited to, the Financial Management Act of 1979. The authority of the allottee to obligate funds appropriated shall not lapse”.*

As an “allottee” of funds, the Pohnpei Port Authority is subject to the requirements of the Financial Management Act of 1979 (Chapter 2 of Title 55 of the Code of the Federated States of Micronesia). Certain sections of Chapter 2 Title 55 that governs the subject appropriation are as follows:

55 FSM § 224 (Disbursement procedures) provides in part:

“Unless otherwise specifically provided by law, the following procedures shall control the administration and management of all funds appropriated from the General Fund of the Federated States of Micronesia or made available to the Federated States of Micronesia from other sources:

- (1) All such funds shall remain in the custody and control of the Secretary of Finance until they are obligated and disbursed by him in accordance with law.*
- (2) Such funds shall be deemed to be obligated as of the date the person or entity to whom the funds are allotted enters into a legally binding written agreement supported by the documentary evidence required by section 219 of this chapter or rules and regulations issued pursuant to authority vested by section 228 of this chapter.”*

55 FSM § 219 (Documentary evidence required to support obligations) provides in part:

“No amount shall be recorded as an obligation of the Government of the Federated States of Micronesia unless it is supported by documentary evidence of:

- (1) a binding agreement in writing, between the parties thereto, including Government agencies, in a manner and form and for a purpose authorized by Federated States of Micronesia law, executed before the expiration of the*

POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES

Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995

CFSM appropriation of \$300,000 received and invested by the Authority, continued:

Criteria, continued:

period of availability for obligation of the appropriation or fund concerned for specific goods to be delivered, real property to be purchased or leased, or work or services to be performed.”

Condition:

On August 10, 1995, the FSM National Government Office of Budget prepared Advice of Allotment no. 401P5213 for \$300,000 to allot appropriated funds to Pohnpei Port Authority (the Allottee), subject to the terms and conditions as described in the project control document (not numbered and not dated), with project description as: “Construction of Kapinga Domestic Runway”. On August 22, 1995, the General Manager of the Authority wrote a letter to the FSM Department of Finance, requesting to expedite the transfer or disbursement of the funds for the Kapingamarangi airstrip. Then, on September 5, 1995, the FSM National Government Office of the Treasury disbursed the money via check no. 00121064 and such was received by the Authority on September 6, 1995.

Afterwards, the Authority’s General Manager, through a memorandum dated September 7, 1995, instructed the Comptroller to invest the money in Time Certificate of Deposits (TCD) with two of the local banks. The reason stated in the memorandum is because the Pohnpei State Office of Construction Management, the Authority’s Airport Division, and Facilities and Construction Division, are presently working on the final engineering plans and estimates of the project.

To date, the construction of the Kapingamarangi airstrip has not yet started and the amount of \$308,841.20 is still invested in TCDs as of September 30, 2001. Of this amount, \$300,000 has been recorded as “Restricted Cash” in the Authority’s financial statements.

Cause:

Several causes have led to the above condition. First, the appropriated fund was obligated and disbursed without a binding written agreement for the work or services to be performed. The grantor also failed to monitor the progress of the project. In fact, the final engineering plans and the cost estimate of the project are not yet done. Secondly,

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

CFSM appropriation of \$300,000 received and invested by the Authority, continued:

Cause, continued:

while we agreed that the management acted prudently in investing the project money in interest bearing accounts instead of leaving it idle; the earnings were not accounted for separately and not restricted pending its final disposition. Then, the construction of the airstrip could not be started because of a disagreement regarding the proposed site. In addition, the Authority's inspection of the proposed site in 1999 revealed that with the type of aircraft that will fly the route, plus the distance of the island to Pohnpei, said aircraft may not be capable for a two-way route without refueling either in Nukuoro or Kapingamarangi.

Effect:

The effects of the above condition are noncompliance to FSM Public Law no. 9-006, delay in the construction of the airstrip, and possible shortfall of project funds due to increases in the material costs and other expenses since 1995 through 2001.

Recommendation:

We recommend strict compliance by all parties to national appropriation laws. Further, the Authority should proceed with the construction of the airstrip if all intricacies have been resolved. Otherwise, we recommend that Pohnpei Port Authority should return the funds appropriated for the Kapingamarangi airstrip, including any interest thereon to the FSM Department of Finance. With this, a corresponding adjustment to reflect the liability to FSM National Government corresponding to the interest earned on TCD should be recorded.

Auditee Response:

Please see Appendix 1.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

Commercial loan of \$100,000 borrowed for the purchase of Airport Sweeper

2. Criteria:

Pursuant to Section 4.3 Article IV of the Pohnpei Port Authority's by-laws, no loans shall be contracted on behalf of the Authority and no evidences of indebtedness shall be issued in its name unless authorized by a resolution of the Board. By this authority, the Authority's Board of Directors approved management's request to secure a commercial loan of \$100,000 to finance the purchase of a vacuum sweeper for the airport's use. Prudent management however dictates that loan funds shall be used for the intended purpose of the loan.

Condition:

Pohnpei Port Authority secured a loan for \$100,000 on July 20, 2000 for the purpose of purchasing a vacuum sweeper for the Pohnpei airport. The loan has an interest rate of 6.60% (1% floating over TCD rate, which is currently at 5.60%), monthly amortization of \$3,700, and maturity date of January 25, 2003. The Authority deposited the money to its current account upon receipt of the loan proceeds. Our review of documentary evidence supporting the disbursements of the loan proceeds disclosed that only \$40,858.53 was spent for the vacuum sweeper. Another \$40,000 was allegedly approved by the Authority's Board of Directors in a July 12, 2000 meeting, to be re-allocated to capital improvement projects. The Authority represented that they spent \$44,879.91 as follows:

<u>Particulars</u>	<u>Amount</u>
Change order for renovation of departure lounge	\$ 5,882.50
Change order for construction of skylight roofing	9,691.10
Purchase of benches for airport departure area	6,580.00
Purchase of air conditioners for airport VIP lounge, departure and arrival areas	8,619.15
Purchase of rotary mower	7,234.01
Purchase of computer printer	420.00
Purchase of typewriter and two filing cabinets	947.95
Purchase of radio-telephone	500.00
Purchase of copier	3,617.20
Purchase of VHF radio and spare battery	1,388.00
Total	\$ 44,879.91

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

Commercial loan of \$100,000 borrowed for the purchase of Airport Sweeper, continued:

Condition, continued:

The Authority did not provide documents to support the disbursement of the remaining balance of \$14,261.56, neither was it able to account for the said amount. Corresponding pictures of some of the purchased assets from the borrowed funds are shown as Exhibits 1a to 1g.

Cause:

The Authority's budget for purchase of airport sweeper was overstated and borrowed more money than the intended use.

Effect:

The above condition resulted to loan funds being used for purposes other than the original intent of the loan.

Recommendation:

We recommend that the management of the Authority should exercise prudent action in the disbursement of its borrowed funds; to ensure that funds are used only for its intended purpose(s). We also recommend that the management should ensure that all funds intended for specific projects should be monitored, expended, and accounted for accordingly.

Auditee Response:

Please see Appendix 1.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

Objective number 2:

Interest income from Restricted Cash deposited to general account

3. Criteria:

FSM Public Law no. 9-006 states that: “the allottee (Pohnpei Port Authority) shall be responsible for ensuring that the funds or so much thereof as may be necessary, are used solely for the purposes specified in the act, and that no obligations are incurred in excess of the sum appropriated”.

In addition, Title 55 Section 209 of the Code of the Federated States of Micronesia (Financial Management Act) states that: “all public moneys...or other revenues collected based on fines, fees, licenses, interests, rents, or other collections of the FSM shall be deposited in the General Fund”.

Condition:

Because the construction of the airstrip has not started and the appropriated money was invested in time certificate of deposits (TCD), we calculated the amount of interest income generated from the \$300,000 investment. Our computation resulted in the amount of \$90,719.15, which represents total interest income generated from the TCDs as of September 30, 2001 (Exhibit 2a to 2c; schedule includes accrued interest income). Of the total interest, only \$11,985.44 has been rolled over with the principal amount, while \$78,733.71 has been deposited to the Authority’s general account, contrary to the Board’s instruction. Because of this practice, the determination on how the Authority used the interest was difficult. We, however, noted in the Authority’s audited financial statements, that the interest income was included in the Authority’s statement of cash flows, as cash provided by investing activities. Therefore, interest income is being recorded as part of the Authority’s unrestricted cash and correspondingly included in the retained earnings.

As part of our analysis on the use of interest income, we present a three-year comparison of the Authority’s budget and actual operating revenues (Exhibit 3), which showed unfavorable variances for fiscal years 1998 and 2000 (actual revenue is less than revenue budget). This variance has led the Authority to possibly use fund from other sources of cash (e.g. cash from investing activities like interest income) in order to fund its expenses for operation and capital outlay, wherein budget was not adjusted regardless of unfavorable revenues for fiscal years 1998 and 2000. Furthermore, the Authority’s audited statements of cash flows, which include cash provided by loans and interest income, reflected net decreases in cash for fiscal years 1998 and 2000.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

**Schedule of Findings and Recommendations
For the years ended September 30, 2001-1995**

Interest income from Restricted Cash deposited to general account, continued:

Cause:

Interest income generated from restricted cash was deposited in the general account, and such amount was not monitored. The above condition also happened because the Authority's budget for operating revenues was not realized.

Effect:

The effects of the above condition are noncompliance with FSM Public Law no. 9-006 and FSM Financial Management Act; and the possible use of the interest income in the Authority's operation and capital outlay to augment the shortfall in actual revenues.

Recommendation:

We recommend that the Authority should return the amount of \$90,719.15, representing interest income generated from the CFMS appropriation as of September 30, 2001 to the FSM National Government. But as latitude, the Authority may ask the National Government for a certain percent of the interest earned as administrative cost, for managing the project money for almost seven years. The Authority's unaudited financial statements as of September 30, 2001 reflected an unrestricted cash balance of \$150,333.50 and net income of \$468,667.73. If the Authority's financial position continues this fiscal year, the Authority may have enough funds for the return of the subject interest.

If, on the other hand the Authority decides to move on with the construction of the Kapingamarangi airstrip, we recommend that the Authority should request the National Government to appropriate the interest earned on investment so that the Authority could legally use the fund as part of the project.

Auditee Response:

Please see Appendix 1.

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

EXHIBITS

FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995

**POHNPEI PORT AUTHORITY
AUDIT REPORT ON AGREED-UPON PROCEDURES**

AUDITEE RESPONSE (APPENDIX 1)

FOR THE YEARS ENDED SEPTEMBER 30, 2001-1995