

**POHNPEI UTILITIES CORPORATION
STATE OF POHNPEI**

**AUDIT REPORT
YEAR ENDED SEPTEMBER 30, 2000**

OFFICE OF THE POHNPEI STATE AUDITOR

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**POHNPEI UTILITIES CORPORATION
STATE OF POHNPEI**

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March 13, 2002

The Honorable Johnny David, Governor, State of Pohnpei
The Honorable Feliciano Perman, Speaker, Pohnpei State Legislature
The Honorable Members of the Pohnpei State Legislature
Mr. Marcelino Actouka, General Manager, Pohnpei Utilities Corporation
Board of Directors, Pohnpei Utilities Corporation

EXECUTIVE SUMMARY

We are pleased to submit the audit report of Pohnpei Utilities Corporation (PUC) for the year ended September 30, 2000. The audit was performed in accordance with auditing standards generally acceptable 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 and Pohnpei State Law no. 1L-10-79, and such other laws promulgated thereafter.

The objectives of our audit were to determine whether:

1. Net loss can be minimized; and,
2. Customers' complaints, if any, are resolved timely and satisfactorily.

Also, as part of our audit, we conducted a review of management controls to determine whether there is reasonable assurance that management's objectives will be achieved efficiently and effectively.

This is the first performance audit performed on Pohnpei Utilities Corporation by the Office of the Pohnpei State Auditor (OPSA). The external auditors have performed financial audits of PUC.

As a result of our audit, we have identified fourteen (14) internal and management control weaknesses, which we have described in detail in the Schedule of Findings and Recommendations on pages 8 through 25 of the report as finding numbers 1 to 14. One of the findings in the draft audit report (finding no. 2) was removed based on response received from PUC. Hence, the audit findings were re-numbered, from finding nos. 3 to 15 to finding nos. 2 to 14. We have also re-worded the “condition” of finding no. 5 on page 13 for added clarity, and have added a percentage column in the “condition” of finding no. 7 on page 16.

The highlights of the report are as follows:

Objective number one

1. We noted PUC’s inconsistency in the implementation of its disconnection policy, which is found on page 10 of the report as finding number 2.
2. Three (3) findings were noted on PUC’s new service, the Cash Power meter system. They are discussed in detail in the Schedule of Findings and Recommendations as finding numbers 3 to 5.
3. Three (3) findings were administrative in nature, and are related to: Salary increase of PUC employees; Budget overrun; and General Manager’s commission. These are detailed on pages 14 to 18 of the report as finding numbers 6 to 8.
4. One (1) of the findings relates to the increase of \$0.05 per kilowatt on the utility base rate in 1996. This increase has led to a court case against PUC, which up to now is still with the Pohnpei State Appellate Division. This is discussed in detail as finding number 12 on page 22 of the report.

Objective number two

5. Our audit disclosed that PUC has incomplete documentation of customer complaints. This finding raises doubt on the timely and effective resolution of complaints. This is discussed on pages 23 to 24 of the audit report as finding no. 13.

As is customary, a draft of this report has been provided to and reviewed by the management of PUC, whose responses and corrective action plans to the findings are included in this report as Exhibit 1 (page 26). As required by the provisions of Pohnpei State Law no. 5L-08-00, an amendment to the law that created the Office of the Pohnpei State Auditor (OPSA), the Corporation is required to submit a monthly report to the OPSA indicating its progress in clearing deficiencies cited in the audit report, which period shall not exceed six months.

In the Schedule of Findings and Recommendations section of the audit report, we have offered our recommendations to each of the findings; we believe once implemented could

assist the Corporation in clearing the deficiencies cited in the audit report and hence, improve its operations.

Lastly, we wish to express our sincerest appreciation to the management and staffs of Pohnpei Utilities Corporation, especially the Accounting and Billing Sections, for the cooperation and assistance extended to us during the course of our audit.

Respectfully submitted,

Ursula S. Abalos
Acting Pohnpei State Auditor

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BACKGROUND

The Pohnpei Utilities Corporation (PUC) is a component unit of the Government of the State of Pohnpei. It was established in 1991 by S.L. No. 2L-179-91 with the sole responsibility of providing electrical powers to the people of Pohnpei State. PUC commenced its operations on October 1, 1991, with assets and liabilities of the Division of Public Utilities of the Pohnpei State Department of Public Works transferred as of that date. Then in 1993, an amending law S.L. No. 3L-41-93 expanded PUC's responsibilities to include water and sewage services. As a result, the assets, liabilities, and operations of the Division of Water and Sewer of the Pohnpei State Department of Public Works were also transferred to PUC effective October 1, 1993. Specifically, both laws vested PUC with the following powers, duties and responsibilities:

- a) To provide electrical power, water and sewage services to the people of Pohnpei through the operation of public utilities system, which meet or exceed health, quality and safety standards established by State law or regulations.
- b) To operate and manage the Pohnpei public utilities system on the basis of commercially accepted practices, treating all users on equitable terms in accordance with its published fees and requiring all users to pay for services rendered.
- c) To expand and improve upon services offered to the public.
- d) To publish and implement a structure of rates for services rendered.
- e) To acquire and maintain from the revenues and grants a program of liability insurance on all personnel, facilities, and equipment.
- f) To invest all surplus revenues of the Corporation in the expansion and improvement of public utilities services.
- g) To acquire land for public purposes.
- h) To enter on any private or public land, house or building in the performance of its duties and responsibilities as authorized by law.

Organization Structure

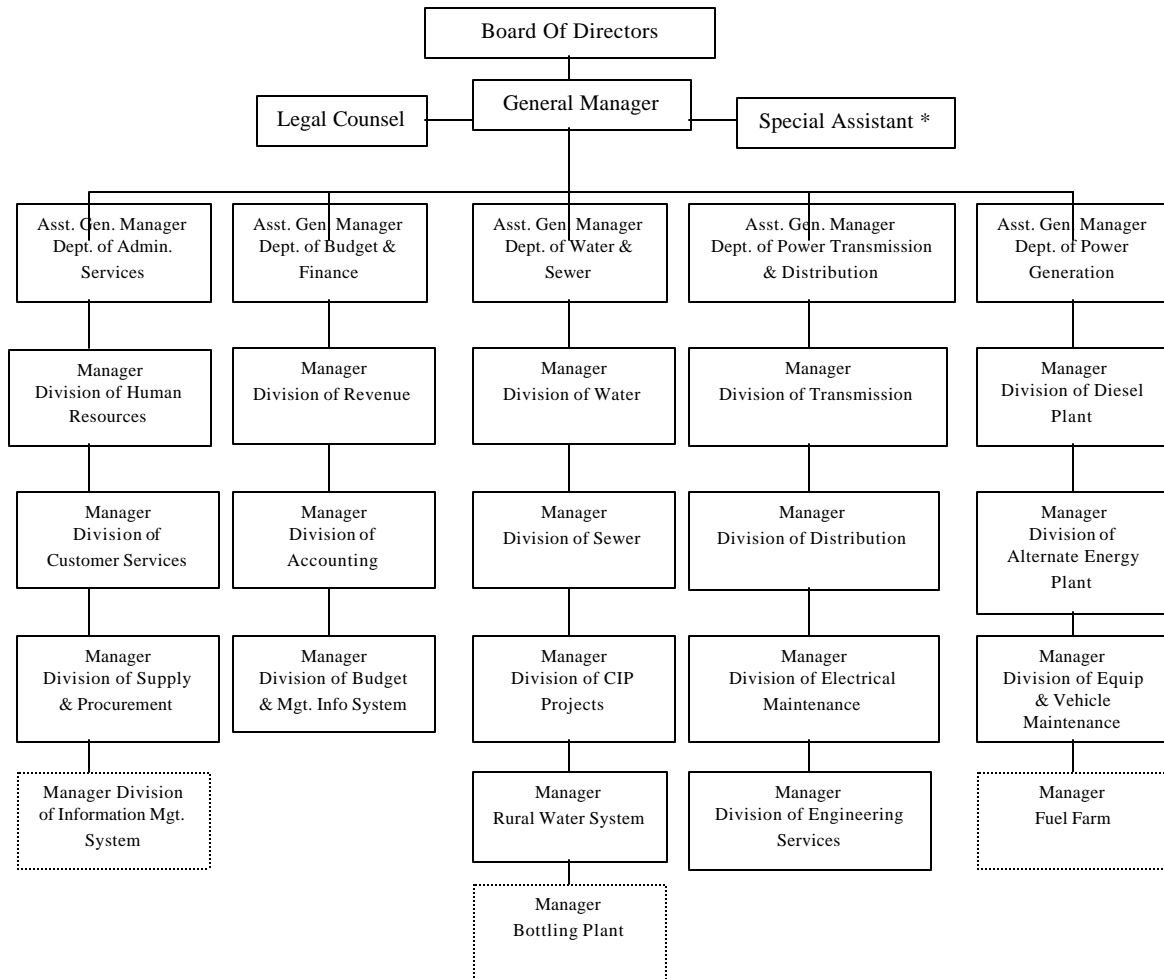
The powers vested in PUC are exercised by a seven-member Board of Directors, who are appointed by the Governor (of whom four are from the private sector and three are from the public sector) with the advice and consent of the Pohnpei State Legislature.

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The General Manager, who is appointed and reports directly to the Board of Directors, has full charge and control of PUC's operations and maintenance of all personal and real properties. He is responsible and accountable to the Board of Directors for the effective conduct of PUC's operations in accordance with the Pohnpei Utilities Corporation Act and within the framework of policies and budgets approved by the Board.

PUC is organized into five departments: Administrative Services, Budget and Finance, Water and Sewer, Power Transmission and Distribution, and Power Generation. Each department is headed by an Assistant General Manager who reports directly to the General Manager. Under each department are divisions and sections with individual managers to supervise the day-to-day activities of their respective areas. (Exhibit 1).

PUC Functional Organizational Chart (Exhibit 1)



*Special Assistants for Strategic Planning, Projects, and Safety & Security.

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Utility Rates

PUC provides electrical power, water and sewage services to the people of Pohnpei at a rate established by the PUC Board in consultation with the Board of Residential Properties and Public Utilities (RPPU), now defunct. Since 1996, the utility rates are costed as follows:

<u>Utility</u>	<u>Customer</u>	<u>Rate per KWH</u>
Power:	Residential & Small General Power Service	Base rate (\$.10) + Average Fuel Cost (AFC) per KWH*
	Large Power Service	Base rate (\$.08) + AFC per KWH*
	Industrial Power Service (0 to 100,000 kwhs)	Base rate (\$.08) + AFC per KWH*
	Industrial Power Service (more than 100,000 kwh)	Base rate (\$.06) + AFC per KWH*
Water	All customers	\$1.80 per 1,000 gallons

* Average fuel cost per gallon for the month (based on Mobil's invoices to PUC) times Efficiency factor (.082).

A comparison of utility rates for the three FSM states is presented below as Exhibit 2.

Utility Rate Comparison - PUC vs Other FSM States (Exhibit 2)

POWER:

PUC			YAP**			KOSRAE**	
<u>Customers</u>	<u>Usage</u>	<u>Rate per KWH</u>	<u>Usage</u>	<u>Rate</u>	<u>Monthly Charge</u>	<u>Usage</u>	<u>Rate</u>
Residential	All Usage	\$0.10 + FC (\$0.068-\$0.103)	0-100 kwh	\$0.13	\$2.50	1-100 kwh	\$0.08
			101-1,000 kwh	\$0.15	\$2.50	101-1,000 kwh	\$0.15
			1,000-5,000 kwh	\$0.17	\$2.50	1,001-10,000 kwh	\$0.18
			>5,000 kwh	\$0.20	\$2.50	10,001-100,000 kwh	\$0.17
						100,000-1,000,000 kwh	\$0.11
Commercial (Small)	All Usage	\$0.10 + FC (\$0.068-\$0.103)	0-5,000 kwh	\$0.17	\$2.50	1-100 kwh	\$0.08
			>5,000 kwh	\$0.20	\$2.50	101-1,000 kwh	\$0.15
Commercial (Large)	All Usage	\$0.08 + FC (\$0.068-\$0.103)				1,001-10,000 kwh	\$0.18
						10,001-100,000 kwh	\$0.17
Government (Small)	All Usage	\$0.10 + FC (\$0.068-\$0.103)	0-5,000 kwh	\$0.17	\$2.50	1-100 kwh	\$0.17
			>5,000 kwh	\$0.20	\$2.50	101-1,000 kwh	\$0.17
Government (Large)	All Usage	\$0.08 + FC (\$0.068-\$0.103)				1,001-10,000 kwh	\$0.19
						10,001-100,000 kwh	\$0.18
						100,001-1,000,000 kwh	\$0.13
Industrial	0-100,000 kwh	\$0.08 + FC (\$0.068-\$0.103)					
	>100,000 kwh	\$0.06 + FC (\$0.068-\$0.103)					

WATER:

PUC			YAP**		KOSRAE**	
<u>Customers</u>	<u>Usage</u>	<u>Rate</u>	<u>Usage</u>	<u>Rate</u>	<u>Usage</u>	<u>Rate</u>
All Customers	All Usage	\$1.80 per 1,000 Gallons	0-5,000 Gallons	\$1.00 per 1,000 Gallons	None	
			5,001-25,000 Gallons	\$2.00 per 1,000 Gallons		
			>25,000 Gallons	\$4.00 per 1,000 Gallons		

** Confirmed from third party.

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Staffing

PUC employs 174 personnel. Total personnel expenses (Salaries/Wages and Employee Benefits) in fiscal year 2000 is \$1,811,558, divided accordingly as follows:

	<u>Amount</u>	<u># of Personnel</u>
Administrative and general	\$ 707,929	46
Generation	414,638	46
Water and sewer	399,781	45
Distribution	289,210	37
Total	<u>\$ 1,811,558</u>	<u>174</u>

Present production

PUC operates a total of four diesel power plants and a hydroelectric plant that produces an average of 40 megawatts of electricity a year. This production services approximately 4,750 power and 2,483 water customers.

New Services

In FY 2000, PUC began installing CashPower Meter to residential and light commercial customers. The CashPower Meter is a prepaid utility meter that incorporates the "Encryption Number Transfer Technology", a relatively new technology for use within American Standard-120/240 volt systems, which transfer power purchases from the utility to the customer using a 16-digit computer generated number feed. The CashPower Meter was offered by PUC to improve its collections, to promote conservation, and improve customer relations. At the end of fiscal year 2000, PUC has more than 700 CashPower Meter customers and is expected to increase to 2000 at the end of fiscal year 2001. PUC also plans to convert all suitable applications (with existing Form 2S revenue meter) to pre-payment technology by year 2005.

OBJECTIVES OF THE AUDIT

The objectives of the audit were to determine whether:

3. Net loss can be minimized; and,
4. Customers' complaints, if any, are resolved timely and satisfactorily.

Also, as part of our audit, we conducted a review of management controls, to determine whether there is reasonable assurance that management's goals and objectives are met,

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that compliance with applicable laws and regulations is ensured, and that resources are adequately safeguarded.

SCOPE AND METHODOLOGY

The period of review for the audit was fiscal year 2000.

Our audit procedures included the following:

- We reviewed the corporation's mission, functions, responsibilities, accomplishments, and management practices.
- We reviewed PUC's compliance with policies on the following functions/areas: receipt, billing, collection, and recording. We also reviewed and tested existing internal controls over these areas to determine whether they are adequate to safeguard the corporation's resources.
- We interviewed various personnel directly involved in operations.
- We reviewed the utility rate costing used by PUC.
- We confirmed from third parties, the utility rates for the other FSM states.
- We reviewed accounts of cash power meter customers to determine if accurate fuel rate was charged.
- We also conducted inspection of the cash power meter to ensure safety standards exist and that the units are not prone to abuse.
- We reviewed the arrears on the cash power meter customers whether they were being paid in accordance with the PUC policy.
- We solicited information concerning salaries from corporations of relatively the same size and type as PUC (on-island and off-island), and compared with PUC employees' salaries.
- We assessed the corporation's responsiveness to its customers by reviewing document files from the Customer Service division's complaint listing.

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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. OPSA is due for peer review this year. The last review was conducted in October 1998. Except for the timeliness of an external quality control review, the audit was conducted 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.

PRIOR AUDIT COVERAGE

This is the first audit of the Pohnpei Utilities Corporation by the Office of the Pohnpei State Auditor. The external auditors have performed financial audits of PUC since its inception.

AUDIT CONCLUSION

As a result of our audit, we have identified fourteen (14) internal and management control weaknesses, which are detailed in the Schedule of Findings and Recommendations, on pages 8 through 25 of our report. Summarized below are our audit findings:

Objective number one:

1. Noncompliance with PUC policy on discounts.
2. Noncompliance with PUC policy on disconnection/reconnection.
3. Fuel rate charged to cash power meter customers were sometimes inconsistent.
4. A cash power meter customer was not charged for operation cost.
5. Inconsistencies of the arrears' balances for cash power meter customers were noted.
6. Salary increases not justified and not budgeted.
7. Overrun in budget.
8. Provision for General Manager's commission for duties inherent in his position.
9. Meter reading records were not adequately maintained.
10. PUC Garage does not have an updated list of vehicle registration allowed for fuel purchases.
11. Fuel Purchase Voucher not issued properly.
12. Base utility rate adjusted without consultation with the Board of RPPU.

Objective number two:

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13. There is incomplete documentation of customers' complaints, including requests for hook-ups.

Objective number two finding, continued:

14. PUC does not maintain monthly run-up of customer balances.

We have also prepared our recommendations to each of the findings, viz:

Objective number one:

1. PUC management should comply with its own policy on discounts and ensure that discounts are only provided to appropriate customers.
2. PUC should comply with its own policy on disconnection/reconnection.
3. PUC should ensure that the fuel rate charged to its customers is consistent and accurate.
4. PUC should establish a control procedure to detect and correct possible error from occurring.
5. PUC should review the arrears for the cash power meter customers to ensure that the amounts recorded are accurate.
6. PUC should ensure that salary increases are budgeted and justified. Management should also identify the source of funds that will finance the increase.
7. PUC should ensure that all anticipated expenditures are fully considered in the annual budget prior to submission. Any amendment to the budget should be approved by the Board and fully documented in minutes of Board meetings.
8. PUC should seek further evaluation on the legality of the payment of incentive to the General Manager.
9. PUC should maintain adequate records of meter readings by ensuring that the reading sheets are signed by the preparer and approving officer, corrections are initialized, and reading work sheets are kept and filed in a secure place.
10. PUC Garage should update its listing of vehicle registration for fuel purchase purposes.
11. PUC should issue the fuel purchase voucher as appropriate.
12. PUC Board and management should work closely with the Governor and Legislature in the establishment of another Board that will perform the functions of the defunct Board of Residential Properties and Public Utilities.

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Objective number two:

13. PUC Customer Service Division should maintain complete documentation of customer complaints.
14. PUC should print and maintain a monthly run-up of customer balances complete with necessary information.

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Objective number one:

Noncompliance to discount policy

1. Criteria: PUC adopted a policy to provide a 10% discount on all accounts that pay their bills in full. The policy also states that the discount was being provided as an incentive to “good” customers and to the “best” customers like the elderly and senior citizens who pay their bills in full by the end of each month.

Condition: Detailed testing of discounts computation for thirty (30) customer accounts, including nineteen (19) accounts of PUC Board and employees, revealed the following:

- a. There were thirteen (13) instances wherein customers were given discounts even though the amount of payment is not enough to avail discounts (representing 90% of total amount due). This situation usually happens when the customer pays one to three days after the payment due date.
- b. Discounts were given to five (5) customers who have arrears (up to 14 months non-payment of utilities), but who elected to pay the total balance due after some time.
- c. Discounts were not provided to three (3) customers who have overpaid their accounts through payroll allotments.

Cause: The reasons below contributed to the above condition:

- Discount and amount of payment were calculated based on previous month’s balance.
- PUC policy did not specify the timeframe eligible for payment of total dues covered by discounts.
- The responsible employee did not provide discounts to customers who have credit balances as a result of regular allotments exceeding the billed usage amount.

Effect: The above condition resulted to immaterial errors in the computation and provision of discounts to customers. Also, the purpose of providing discounts, which is to provide an incentive to “good” and “best” customers who pay their bills in full by the end of each month, was not obtained.

Recommendation: We recommend that PUC management should comply with its own policy on discounts and ensure that discounts are only provided to

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appropriate customers. In addition, PUC management should also provide in the discount policy, a timeframe for the full payment of total balance due.

Noncompliance to discount policy, continued

Auditee Response: Please see Exhibit 1.

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Noncompliance to PUC policy on disconnection

2. Criteria: PUC policy dictates the disconnection of service for 90-day past due accounts.

Condition: We reviewed the statement of accounts of thirty (30) customers and noted lapses in the implementation of the disconnection/reconnection procedures, as follows:

- Customers accounts past due for 4 months to 22 months and are not disconnected.
- Two- (2) customer account nos. 260320000 and 520240000 did not make payments during fiscal year 2000 up to July 2001 but are still active to date.
- Two- (2) disconnected accounts (nos. 2603200000 and 4601430000) were reconnected even though the customers did not make payments of the accounts.
- Five (5) customers were making monthly allotments but were not enough to pay for monthly billings, thereby resulting to increasing dues.

We also reviewed the accounts of forty-two (42) delinquent customers as of September 30, 2000 and noted that while twenty-four (24) account balances increased as of September 13, 2001, only nine (9) accounts were disconnected. We verified the details of eleven (11) accounts that were not disconnected and found that:

- Three (3) accounts did not make any payments during fiscal year 2000 up to September 12, 2001.
- Eight (8) customers did not make regular monthly payments on their accounts.

Cause: The disconnection policy was not strictly enforced by PUC management.

Effect: The above condition resulted to PUC providing services to non-paying customers. Also, there is loss of revenue for PUC resulting from the above condition.

Recommendation: We recommend that PUC should strictly implement its policy on disconnection. PUC should also investigate why some customers are being favored.

Auditee Response: Please see Exhibit 1.

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Inaccurate Fuel Rate for Cash Power Meter Customers

3. Criteria: A control mechanism in place should ensure that all customers are charged accurate rate for services provided.

Condition: Our review to ascertain the accuracy of power cost, particularly the fuel rate charged to cash power customers indicated that there were instances where the fuel rate is inconsistent or is slightly inaccurate resulting to customers paying less or more for fuel cost. The discrepancies noted are as follows:

	Date of Purchase	Receipt Number	Fuel Rate Charged	Correct Fuel Rate
Customer 1	5/16/00	4605	.0903	.1001
	5/20/00	4810	.0903	.1001
Customer 2	5/18/00	4721	.0903	.1001
Customer 5	5/22/00	4875	.0904	.1001
Customer 6	12/2/99	736	.0684	.0727
	12/3/99	739	.0684	.0727
	12/17/99	851	.0726	.0788
Customer 7	8/14/00	2691	.0949	.0982
Customer 11	7/6/00	1503	.1002	.0993
Customer 12	4/28/00	3776	.0915	.0903

Cause: One probable cause for this condition is that the wrong percentage was deducted against customer's arrear.

Effect: The condition may be immaterial with small purchases of electrical power, however, for large purchases it could lead to material over or under charge of fuel cost to customers.

Recommendation: We recommend that PUC investigate the cause for the fuel rate inconsistency and ensure it is corrected.

Auditee Response: Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated March 1, 2002: We have reviewed the accounts again taking into consideration the 10% discount, and we agreed to delete only findings that related to Customers 3, 4, and 8-10. The rest of the findings remain in the report.

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Operation Cost Not Considered

4. Criteria: There should be a control procedure in place to ensure that all sales of electrical powers are fairly accurate.

Condition: During our review of cash power, we noticed that a receipt number 222, dated 5/23/00 for a \$100 purchase of electrical power, indicated that the customer received 999-kilowatt hours of power for the purchase. The error was detected and corrected but not after the sale was already executed.

Cause: Control detecting error(s) before the sale is made was not sufficient.

Effect: The customer was not charged for operation cost and resulted to PUC incurring a loss of about \$99 worth of electrical power sales.

Recommendation: We recommend that PUC should establish a control procedure to detect and correct possible error before each sales of electrical power is made.

Auditee Response: Please see Exhibit 1.

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Incorrect Customers' Arrear

5. Criteria: Customers' arrears reflected in the detail transactions for each customer should be equal to the amount reflected in the schedule of arrears for cash power customers.

Condition: In our review of thirty-five (35) accounts of cash power customers, we noted that the amounts of arrears for seven (7) customers as shown in the detail transaction are different from the amounts reflected in the schedule of arrears for cash power customers.

Cause: The schedule of arrears of cash power customers is not updated.

Effect: This condition if not corrected, will lead to overstatement or understatement of cash power customers' arrears.

Recommendation: We recommend that PUC review and update the schedule of arrears for cash power customers and reconcile it with the details of accounts to ensure that the amounts recorded are accurate.

Auditee Response: Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated March 1, 2002: The first detail transaction for cash power customer's arrears provided to OPSA was printed on August 15, 2001; another schedule of cash power customers' arrears was provided to OPSA on September 19, 2001. The two schedules showed the discrepancies. The later report was already corrected.

We acknowledged PUC's response and action taken to correct the seven (7) items cited in the report, however, since OPSA only reviewed thirty-five (35) accounts, the probability, although not scientifically calculated that the accounts not reviewed that may contain similar "human posting error" could be more. We therefore maintain this finding to reiterate our recommendation.

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Salary Increases not justified and not budgeted

6. Criteria: Prudent management dictates that while it is true that salary increases serve as incentive to employees, the increases shall be justified and given within the financial capability of the corporation. Furthermore, it should be budgeted.

Condition: In August 1, 2000, PUC management and Board approved the salary increases of 5%-10% on almost all of its employees' salaries, including contractual employees. One contract employee received a 5% salary increase while having served the corporation for only ten months. The total cost of the increase is \$173,635 annually, summarized by departments as follows:

<u>Department</u>	<u>Amount of Increase</u>
Executive	\$ 6,664
Department of Administrative Services	15,160
Department of Budget & Finance	6,024
Department of Water and Sewer	52,628
Department of Power Generation	61,124
Total	\$ 173,635

In addition, PUC's top two management positions received annual increases of \$15,000 and \$10,000. The salary increase was recommended and approved without justification or identification of source of funds. The increase was not also budgeted in fiscal year 2000.

We also solicited information on the amount of salaries offered to 13 selected positions from 3 other corporations of relatively the same size and type as PUC (2 are in Pohnpei and 1 off-island), and from Pohnpei State Personnel office. A comparison of the information received with PUC employees' salaries disclosed that PUC ranked second highest in terms of salaries provided to its employees.

Cause: The cause of the above condition is unknown.

Effect: The audit reports of PUC for fiscal years 1999-2000 reported operating losses of \$1,766,606 and \$1,506,257 respectively. Without additional operating revenue, PUC's operating loss will increase as a result of the above condition.

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Salary Increases not justified and not budgeted

Recommendation: We recommend that salary increases should always be budgeted and justified. Management should also identify the source of funds that will finance the increase.

Auditee Response: Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated March 1, 2002: The General Manager's (GM) report no. 44/00 regarding Salary Adjustment/Increase of 5-10%, which the PUC Board approved, did not include justification for the salary increase of PUC employees. GM's report no. 12/00 regarding Contracting Employees is irrelevant to the justification. GM's report no. /01 and /02 may have given some sort of justification but it only pertains to the top-level management. Both reports were not signed by the General Manager and the GM's report no. /01 was dated January 18, 2002. The auditors believe that the above-mentioned reports/documents are not sufficient to delete this finding.

In addition, prudent management action dictates that expenses that could impact an amount of \$173,000 per year should not be expended without a budget unless extremely emergency in nature.

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Budget overrun

7. Criteria: PUC's accounting manual states that: "An annual budget shall be prepared by the General Manager, through the Comptroller, and must be reviewed and approved by the Board of Directors. The approval of the budget will then constitute approval of all expenditures made by the corporation. In addition, the General Manager may reprogram budgeted expenditures between categories without Board approval up to a maximum of 15% of the total budget for the category being reprogrammed. The reprogramming for larger adjustments must be presented to the Board for approval."

Condition: By comparing PUC's audited expenditure amount with PUC's budget for fiscal year 2000, we noted the following expenditures that exceeded the budget.

<u>Operating Expenses</u>	<u>Budget*</u>	<u>Actual**</u>	<u>Variance</u>	<u>%</u>
Chemicals	\$ 40,000	\$ 48,066	\$ (8,066)	(20)
Communications	40,000	60,911	(20,911)	(52)
Customer service & collection	0	67,004	(67,004)	(100)
Employee benefits	376,784	455,759	(78,975)	(21)
Repairs & Maintenance	606,500	824,282	(217,782)	(36)
Other production	0	27,135	(27,135)	(100)
POL	2,713,403	3,229,285	(515,882)	(19)
Travel	75,000	93,300	(18,300)	(24)

* includes budget amendment per GM report 8/00 approved by the Board in meeting of 4/14/00.

** does not include Depreciation and Bad debts expenses that were also not budgeted.

Cause: The cause of the above condition is unknown.

Effect: The effect of the above condition is an overrun of actual expenditures against budget by \$2,355,767.

Recommendation: We recommend that PUC should ensure that all anticipated expenditures are fully considered in the annual budget prior to its submission. In addition, any budget amendment should be approved by the Board and fully documented in minutes of Board meetings.

Auditee Response: Please see Exhibit 1.

POHNPEI UTILITIES CORPORATION
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Budget overrun, continued

Auditor's Reply to Auditee's Response dated March 1, 2002: PUC, being a proprietary fund type, uses the accrual basis of accounting. Hence, all expenses incurred and not yet paid, should be accrued and recorded. In addition, a supplemental budget should be prepared by management and submitted to the Board for approval if the need arises.

POHNPEI UTILITIES CORPORATION
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General Manager's commission from collections

8. Criteria: Section 10 of Pohnpei State Law no. 2L-179-91 identifies the powers of the General Manager of Pohnpei Utilities Corporation, which include the responsibility to ensure that all fees and bills imposed by the corporation are charged and collected.

Condition: The General Manager (GM) signed a contract with PUC for two years employment ending February 23, 2002. Section 5 of the contract provides the GM to receive "an incentive amount of \$1,250 every month when total collections amounts to \$600,000 or more".

During the year 2000, there was an increase of collection from 1999 of \$795,249. However, we noted that the bulk of collections came from cash power meter services, which are approximately \$302,974 for fiscal year 2000.

Cause: The Board wanted to motivate the General Manager to intensify collections.

Effect: It appears that PUC is paying its General Manager additional compensation for a duty that is inherently one of his duties and responsibilities pursuant to S.L. no. 2L-179-91.

Recommendation: We recommend that the PUC Board seek further evaluation on the legality of the General Manager's commission as incentive.

Auditee Response: Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated March 1, 2002: It is also in the PUC's legislation (PSL no. 2L-179-91) which identifies the duties of the General Manager (GM) to include that the GM ensure that all fees and bills are charged and collected.

POHNPEI UTILITIES CORPORATION
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Inadequate maintenance of meter reading records

9. Criteria: The meter reading is the basis of PUC's monthly billings. Hence, the readings should be properly done, verified and securely kept for future references.

Condition: For 239 selected customers; we tested PUC's meter readings for three months and compared them to billing records.

The monthly reading of customer meter is written in a Read Entry Work Sheet (REWS). However, the preparer and approving or reviewing officer did not sign the REWS. Corrections to the readings were also not initialed. In addition, there are some REWS missing at the Revenue/Finance Section, and thus, we could not verify the correctness of the usage billed to customers.

We also compared the 3 months fuel reading at the PUC plant to the total gallons on hand listed in the Average Diesel Fuel Cost Report. This report computes for the average fuel cost per kilowatt charged to customers. The reader and the approving officer did not sign the fuel reading sheet. Likewise, we noted that corrections made to the readings for total gallons on hand were not initialed.

Cause: PUC personnel did not maintain adequate records of customer and fuel meter readings.

Effect: Absence of adequate records on meter readings may result to unsupported customer complaints and other legal issues in the future.

Recommendation: We recommend that PUC should maintain adequate records of meter readings by:

1. Ensuring that all meter readers sign the REWS to pinpoint responsibility. Likewise, the reading sheets should be signed by the reviewer or approving officer.
2. Any notes or corrections on the readings shall be initialed by responsible personnel.
3. Monthly REWS for all routes shall be kept and filed in a secure place.

Auditee Response: Please see Exhibit 1.

POHNPEI UTILITIES CORPORATION
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Absence of updated vehicle registration

10. Criteria: PUC policy allows all PUC employees to purchase fuel from PUC garage for their personal use. Employees who wish to participate in the program shall register one personal vehicle to PUC garage and only the registered vehicle shall receive fuel from the garage.

Condition: We reviewed one month of fuel purchases in FY 2000 and compared the vehicle numbers with the registration listing. We found instances of discrepancies between the vehicle numbers. We also found fuel purchases by vehicles not in the registration listing. When asked, the PUC garage personnel informed us that the garage does not have an updated list of vehicle registration.

Cause: The responsible employee did not update the vehicle registration listing for fuel purchase purposes.

Effect: The above condition resulted to noncompliance to PUC policy.

Recommendation: We recommend that PUC Garage should update its listing of vehicle registration and ensure that only registered vehicles will be allowed to purchase fuel.

Auditee Response: Please see Exhibit 1.

POHNPEI UTILITIES CORPORATION
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Year Ended September 30, 2000

Fuel purchases

11. Criteria: The Fuel Purchase Voucher served as documentation for fuel purchases by PUC employees. Hence, at all times, it should be issued as appropriate and stamped paid, evidencing receipt of payment from employee.

Condition: We reviewed one month of employees' fuel purchases and we noted the following:

1. There were nine fuel purchase vouchers that were not stamped paid by cashier. Employees were able to get fuel though.
2. In two instances, the fuel purchase vouchers were issued out of sequence.
3. Three fuel purchase vouchers could not be located and are presumed missing or lost.
4. Six instances where the amount reflected in the fuel purchase voucher do not tally with the quantity of fuel purchased.

Cause: The above condition maybe an oversight on the part of the cashier/s.

Effect: The above condition might have resulted to immaterial errors in the sale of fuel to employees.

Recommendation: We recommend the following control procedures in the issuance of fuel purchase vouchers:

1. Ensure that the fuel purchase vouchers are issued sequentially.
2. Ensure that upon receipt of cash, the fuel purchase vouchers are stamped paid by cashier.
3. Ensure that the fuel purchase vouchers are kept intact.
4. Ensure that the correct amount of fuel purchase is reflected in the fuel purchase voucher.

Auditee Response: Please see Exhibit 1.

Auditor's Reply to Auditee's Response dated March 1, 2002: We have only reviewed one (1) month of fuel purchases and have found six (6) instances of fuel purchase amount that do not tally with the fuel purchase quantity. For the remaining eleven (11) months not tested, there is a probability, although not scientifically calculated, that similar errors could occur. We maintain this finding

POHNPEI UTILITIES CORPORATION
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in order for PUC management to formulate additional control procedures in the issuance of fuel purchase vouchers.

Base rate adjusted without consultation with Board of RPPU

12. Criteria: Pohnpei State Law no. 3L-41-93 states that PUC is vested with the power to publish and implement a structure of rates for services rendered by the corporation. Such rates are to be determined by the Board of Directors after consultation with the Board of Residential Properties and Public Utilities (RPPU).

Condition: An increase of \$0.05 per kilowatt on the utility base rate was implemented by PUC in 1996. The increase was made without consultation with the Board of RPPU due to its abolishment in 1995. All PUC customers are paying the utility base rate at \$0.10 per kilowatt from 1996 up to present, with the exception of one customer as per court ruling.

Cause: The above condition happened because the Board of RPPU was dissolved and its functions were not transferred to another body/office.

Effect: The above condition has resulted to a court case against PUC, which at present is still under appeal. If the court eventually decided against PUC and ordered reimbursement of all customers for the overpayment, PUC might face a substantial cash flow problem from this situation.

Recommendation: We recommend that PUC Board and management work closely with the Governor and Legislature in the establishment of another Board that will perform the functions of the defunct Board of RPPU. In addition, we recommend that PUC should exert effort to calculate the amount involved in case of unfavorable decision by the court. If the amount is material, we suggest that a corresponding liability should be recorded.

Auditee Response: Please see Exhibit 1.

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Objective number two:

Incomplete documentation for customers' complaints, including requests for hook-ups

13. Criteria: Documentation for customer complaints including its resolution should be maintained properly.

Condition: From the computer log of Customer Service Division (CSD), we selected 95 samples for testing of customer's complaints. We traced these complaints from the time they were received by PUC up to the time these complaints were resolved. We noted that although the CSD maintains a computer log of complaints received, it did not maintain information on the resolution of the complaints. Per inquiry with CSD personnel, we were informed that all complaints received by CSD were recorded in work orders, numbered by the CSD personnel. These work orders were forwarded to respective divisions (either power or water) for the necessary actions. We traced the work orders as they are resolved by the power and water divisions and found that most of the work orders were not properly filled out and did not contain information on the resolution date of the complaints. The water division though, had a computer log of daily job orders where the information we needed could be verified.

From the same computer log of Customer Service Division (CSD) as of September 30, 2000, we identified the requests for new hook-ups, numbering about 306. We then traced these hook-ups to the masterlist of PUC customers as of September 30, 2000 to determine if they were billed, and we noted that there were 118 hook-ups that were not in the list. We again traced these hook-ups to the records of CSD, as well as power and water division to determine when the hook-ups were completed. Our verification revealed that these divisions did not have information on the dates of hook-up. We tried confirming the hook-up dates with the customers but most of them already forgot the exact date of hook-ups. One customer though informed us that PUC billed him 5 months after the hook-up.

Cause: The responsible employees were not aware of the necessity of maintaining complete documentation of non-financial transactions/records.

Effect: The above condition raises doubt as for the timely and effective resolution of customers' complaints. Also, the auditors were not able to apply alternative audit procedures to determine if new hook-ups were billed on time.

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Incomplete documentation for customers' complaints, including requests for hook-ups, continued

Recommendation: We recommend that PUC's Customer Service Division should maintain complete documentation of customers' complaints by:

- Maintaining a computer log of customer complaints, including hook-ups, that will include information as follows: date of complaint, name of customer/complainant, nature of complaint, status of complaint, date resolved or completed, division or individual who resolved the complaint.
- Monitoring the work orders forwarded to other divisions for the necessary actions and requesting these divisions to return copies of the properly filled up work orders after the complaints are resolved.
- Filing the resolved work orders by number. These completed work orders will become the basis for the information in the computer log.

We also recommend that PUC should have a written policy for resolving or handling complaints.

Auditee Response: Please see Exhibit 1.

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Run-up of customer balances

14. Criteria: As a control measure, PUC should keep hard copies of record of customer balances aside from the information stored in the computer.

Condition: PUC does not have hard copies of monthly records of customer balances and/or billing registers. Customer records are printed only when needed.

Cause: According to the Account Technician, PUC stopped printing the billing register when the computer program was changed sometime in 1999.

Effect: PUC might lose valid customer information regarding payment, billing and meter reading in case of computer breakdowns.

Recommendation: We recommend that PUC print monthly records of customer balances containing information as usage billed, amount billed, previous month's balance, etc. PUC should also ensure that the reports are securely kept.

Auditee Response: Please see Exhibit 1.

POHNPEI UTILITIES CORPORATION

AUDITEE RESPONSE (EXHIBIT 1)

YEAR ENDED SEPTEMBER 30, 2000