

OFFICE OF THE NATIONAL PUBLIC AUDITOR
FEDERATED STATES OF MICRONESIA

**REVIEW OF CONGRESS FUNDED PUBLIC PROJECTS
IN KOSRAE STATE
FISCAL YEARS 2005 - 2006**

ONPA NO. 2008-01



Haser H. Hainrick
National Public Auditor



FEDERATED STATES OF MICRONESIA

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October 29, 2007

His Excellency Manny Mori, President
Honorable Members of the FSM Congress
Federated States of Micronesia
Palikir, Pohnpei FM 96941

RE: Review of Congressional funded public projects in Kosrae State pursuant to Public Law 13-36

We have completed our review of the FSM Congress appropriations for public projects in the State of Kosrae for fiscal years 2005-06 as funded under Public Law 13-36 (CFSM appropriation law), and amended by Public Law 13-49. Our objectives were to determine: (a) whether appropriate processes for reviewing and selecting projects were followed for CFSM public projects; and (b) whether implementations of CFSM public projects were in accordance with laws and regulations. We conducted our review in accordance with the Quality Standards for Inspections issued by the *U.S. President's Council on Integrity and Efficiency* and the *Executive Council on Integrity and Efficiency*.

We found that Congress members did not have a formal process for selecting public projects nor did they use project selection criteria commonly employed by other government entities. Because CFSM projects were not required to adhere to these selection criteria and because we found that the majority of projects selected by Congress members did not meet these criteria, we question whether the public projects selected and funded were a proper use of CFSM funds.

We also found that project management officials did not follow the Financial Management Regulations (FMR) in implementing CFSM projects. In some instances, noncompliance with the FMR led to mismanaged and misused project funds resulting in higher costs and overpriced purchases. In addition, over \$100,000 of project funds were improperly disbursed from the National Treasury. In other cases, the Project Control Documents (PCD) were not sufficiently clear or complete as required by the FMR, thus preventing oversight officials from ensuring that project expenditures were for their intended purposes. Having discussed our findings with pertinent officials, we provided them an opportunity to submit their written comments for inclusion in the report. We have not received the desired management comments, and therefore have issued this report without them. Our findings and recommendations are described in detail in the attachment to this letter.

Respectfully yours,

A handwritten signature in black ink, appearing to read "H. Hainrick", is written over the closing text.

Haser H. Hainrick
National Public Auditor

Office of the FSM Public Auditor
Review of Congress Funded Public Projects in Kosrae State
ONPA 2008-01

TABLE OF CONTENTS

BACKGROUND.....	1
OBJECTIVES, SCOPE, AND METHODOLOGY	1
PRIOR AUDIT COVERAGE & REFERRALS	2
CONCLUSIONS.....	3
FINDINGS AND RECOMMENDATIONS	
Selection Standards Not Met Resulting in Questionable Public Projects.....	3
Cause and Recommendation	6
Prudent Management Practices Not Followed Resulting in Mismanaged and Misused Project Funds	7
Cause and Recommendation	9
APPENDICES:	
I—CFSM Public Projects in Kosrae with Amounts Expended	11
II—Legal Opinion on CFSM Public Projects	12
III—Project Description and Exceptions Noted for Selected Projects	15
NATIONAL PUBLIC AUDITOR’S COMMENTS.....	21
ONPA CONTACT AND STAFF ACKNOWLEDGEMENT	22

BACKGROUND

Congress overrode the President's veto during its Third Regular Session of the 13th Congress to pass Public Law 13-36 (CFSM¹ appropriation law). The Law appropriated \$2.8 million from local revenues (non-Compact) to provide funding for social and economic development projects in the four States of the Federated States of Micronesia (FSM). The funds were allocated in proportion to the number of Congressional members (\$200,000 per member). For the State of Kosrae, which has two congressional members, \$200,000 was apportioned to statewide projects and \$200,000 to regional projects for a total of \$400,000. CFSM appropriation law was subsequently amended (Public Law 13-49) to incorporate specific projects and their funding amounts selected by Kosrae's Congressional members. See Appendix I on page 11 for the CFSM project descriptions and appropriations for the State of Kosrae.

The CFSM appropriation law designated an allottee to be responsible for ensuring that individual projects are implemented in accordance with regulations. For example, the allottee should ensure that the Project Control Document (PCD) is properly prepared. The PCD contains descriptive information of the project's purpose, budgeted funds, benefits, and implementation strategy, which allows oversight officials to assess whether project expenditures are appropriate and allowable. The FSM Budget Office must approve the PCD in order for project funds to be allotted.

OBJECTIVES

The objectives of this inspection were to determine: (a) whether appropriate processes for reviewing and selecting projects were followed for CFSM public projects; and (b) whether implementations of CFSM public projects were in accordance with laws and regulations.

SCOPE AND METHODOLOGY

The review covers Congressional appropriations (Public Law 13-36 as amended) for public projects in Kosrae State for fiscal years 2005-06. However, the gathering, reviewing and testing of relevant information and documentations included previous and subsequent periods for analytical purposes. The review was conducted pursuant to Title 55 FSM Code, Chapter 5, which states in part:

“The Public Auditor shall inspect and audit transactions, accounts, books, and other financial records of every branch, department, office, agency, board, commission, bureau, and statutory authority of the National Government and of other public legal entities, including, but not limited to, States, subdivisions thereof, and nonprofit organizations receiving public funds from the National Government.”

¹ CFSM refers to “Congress of the FSM” and is used in reference to public projects funded by the Congress of FSM.

We performed the review in accordance with the *Quality Standards for Inspections* issued by the PCIE and ECIE² and included tests of records, transactions, and other auditing procedures that we considered necessary under the circumstances.

The audit fieldwork was conducted at the FSM Department of Finance & Administration (DoF&A), Kosrae State Department of Education, State Department of Health, FSM Finance Field Office in Kosrae, FSM Customs and Tax Administration, Kosrae Utility Authority, the Kosrae Congressional Delegation Office and Municipal governments for Lelu, Tafunsak, Malem and Utwe. For our question regarding selection methods, we reviewed the proposals for all the 34 public projects. We also reviewed the criteria used by other regional agencies in their project selection process (Compact Capital Improvement Projects, Australian Embassy Application for Small Grants Scheme, The Global Environment Facility Small Grants Programme – New Zealand Aid Pacific Fund Partnership). For our question regarding the implementation of projects, we reviewed the Project Control Document for all 34 projects and judgmentally selected 25 projects for detailed review.

Inspection procedures included analyzing PCD, funding reports, expenditures, and contracting practices for public projects funded by the Congress in Kosrae State. Accordingly, we reviewed contracts, checks, invoices, and receipts. We also observed the current condition of the construction related projects. We interviewed National, State and Municipal Government officials, as well as project managers at various organizations. The review included tests of records, transactions, and other procedures that were necessary to meet our objectives.

We provided our draft findings at exit meetings held with the two Kosrae Congressional members. We also briefed the Lt. Governor of Kosrae, the Directors of Education and Health, and three municipal mayors. During our briefings, the officials generally agreed with our findings. We provided a copy of the draft report to the President, Vice President, the Chairman of Kosrae Congressional Delegation, the Governor of Kosrae, and the FSM Secretary of DoF&A for their review and comments. We did not receive any written comments to be included in the report, therefore we are issuing the report without them.

PRIOR AUDITS COVERAGE & REFERRALS

This inspection is part of a full review of all four States undertaken by the Office of the National Public Auditor (ONPA) on public projects funded by the Congress of the FSM under Public Law 13-36. We completed another part of this review for CFSM public projects in Yap State, *Inspection of Congress Funded Public Projects in Yap State, Fiscal Years 2005-2006*, issued April 26, 2007. The last full audit report of all four states, *Public Projects Funded by the Congress of the Federated States of Micronesia, Fiscal Years Ended September 30, 1997, 1996, 1995 & 1994* was issued April 7, 1999.

Throughout this report, we identified findings that were previously reported. Although not specifically identified in the report, we referred some findings to the National Public Auditor's Compliance Investigation Division for further review.

² U.S. President's Council on Integrity & Efficiency (PCIE) and the Executive Council on Integrity & Efficiency (ECIE)

CONCLUSIONS

We found that Congress members did not have a formal process for selecting public projects nor did they use project selection standards commonly employed by other government entities. Because CFSM projects were not required to adhere to these selection standards and that the majority of projects selected by Congress members did not meet these standards, we question whether the projects selected and funded were a proper use of CFSM funds. We also found that project management officials did not follow the Financial Management Regulations (FMR) in implementing CFSM Public projects. In some instances, noncompliance with the FMR led to mismanaged and misused project funds resulting in higher costs and overpriced purchases. In other cases, the Project Control Documents (PCD) were not sufficiently clear or complete as required by the FMR, thus preventing oversight officials from ensuring that project expenditures were for their intended purposes.

FINDINGS AND RECOMMENDATIONS

Selection Standards Not Met Resulting in Questionable Public Projects

The Congressional members from Kosrae selected projects without having a clear definition of the purpose for CFSM projects nor did they use selection standards or proposal guidelines. We reviewed selection methods used by agencies in the region and determined four commonly used selection criteria. Applying these criteria, we found that most CFSM projects did not meet the selection standards commonly used in the region, and therefore we question whether the projects selected and funded were a proper use of CFSM funds.

Even though Congress did not clearly define the purpose of CFSM projects in the legislation nor did it have standards for selecting CFSM projects, they selected projects from proposals received from their constituents. While the CFSM appropriation law indicated its purpose was to fund social and economic development projects in the States, it did not define the term “social and economic development projects.” Nor did Congress provide guidance on which social and economic development projects are appropriate use of the funds. The Department of Justice (DOJ) advised the Office of the National Public Auditor that the Law is “defective” because it failed to provide sufficient guidance on how to determine what kind of project qualified for these funds. (See appendix II on page 12 for DOJ’s letter.)

In addition, when Kosrae Congress members selected public projects to fund under CFSM appropriation law, they did so without following the selection standards employed by other government agencies. The Congress members received proposals from constituents, organizations, and municipalities. In addition, Kosrae Congress members proposed activities they believed were important to the community. Congress members made their selections from among all these proposals, but they did not have a formal process or standards for selecting projects. Because Congress members did not have standards nor did the legislation clearly define the social and economic development purpose for the public projects, we could not use their criteria to evaluate the projects selected.

To evaluate the CFSM public projects, we reviewed regional agencies³ methods and standards and found four standards that were commonly used in selecting public projects. For example, in the region we found that many public projects are scrutinized through annual State and National budget processes or reviewed through an infrastructure development planning process. Although the standards and criteria for a public project varied among the agencies, they all contained similar elements that helped the selecting agency evaluate projects. The four standards actually defined the public project and directed the information to be contained in the proposals. These commonly used standards are:

1. A public project’s purpose and methodology should be easily understood and therefore the proposal should contain a clear description of the project envisioned.
2. A public project should be reasonably priced and provide value for the money and therefore the proposal should have a detailed estimate of expected outlays and a justification for estimated costs.
3. A public project should provide a benefit to the community it serves and therefore the proposal should contain a clear description of who would benefit and how they would benefit from the project.
4. The implementation of a public project should be monitored to ensure that the project is carried out as envisioned and therefore a project proposal should contain an implementation plan.

Using the four common standards for public projects, we reviewed the proposals that Congress used to select the projects and found that 88 percent (30 of 34) of the CFSM projects did not meet all four standards. See table 1 below. Because most CFSM projects did not meet the selection standards commonly used in the region, we question whether the public projects selected and funded were a proper use of CFSM funds.

Table 1: Schedule of Selection Standards and Number and Percentage of Exceptions Noted

Selection Standard Exception	Number of Projects Proposals with Exceptions Noted	Percentage of Proposals with Exceptions Noted
Proposals Without Clear Description	20	59%
Proposals Without Detailed Costs	20	59%
Proposals Without Description of Benefits	22	65%
Proposals Without Implementation Plan	27	79%
Number of Proposals with at Least One Exception Noted	30	88%
Number of Proposals Reviewed	34	

Source: ONPA table based on review of project proposals

Detailed Description —A detailed description of the public project should identify the purpose, and the amount and type of work to be performed to enable a proper review and assessment of the public project. However, in nearly 60 percent of the project proposals, CFSM project descriptions were not clearly stated or described in detail. Many proposals were written in broad and unspecified terms reflecting the organization’s ongoing and recurring activities, rather than

³ See page 3 (Scope and Methodology) for regional agencies reviewed for project selection criteria

details on a specific activity to be funded. For example, one proposal for Youth Development specified “Youth Night Activities” but contained no details such as the objective, type of events, and the number and age of expected participants. As a result, Congress was unable to assess the nature or purpose of the activities to be funded.

Detailed Costs — A detailed cost estimate for a project should include price justifications to enable an assessment of the reasonableness of the amount of funds requested. However, in nearly 60 percent CFSM projects proposals, costs were not detailed enough to assess whether the project funds requested were reasonable.

- In some cases, project proposals contained no detail costs; they only listed the dollar amount of funds requested for each activity. For example, one Municipal government requested \$5,000 for office renovation with no details on the cost of materials and labor to be used. Therefore, Congress had no basis for evaluating whether the funds requested were reasonable.
- In some cases, a project proposal contained a request for funds with no explanation for how the estimated price was determined. For example, a mayor requested \$14,000 to acquire land for a community playground project. Property acquisition regulations (56 FSMC §201-209) require real property to be appraised for fair market value and a just compensation amount established before negotiations are initiated. Although an appraisal was not acquired, two parcels of land were purchased for negotiated prices of 500 and 800 percent higher than surrounding land values. Of note was the fact that the seller of one of the parcels was also a member of the municipal council. If the project proposal had included an appraisal of the fair market value, the inflated purchase costs could have been avoided. See Appendix III for more information on Land Acquisition for Malem Municipality on page 18.

Description of Benefits — A clear description of a project’s benefits to the community and an explanation of who would benefit from the project is needed to assess the project’s suitability as a public project to receive CFSM funding. However, we noted 65 percent of the project proposals did not include a specific description of benefits expected. In most other cases, project benefits were not clear regarding whom specifically would benefit or what benefit would be derived. For example, Congress appropriated \$5,000 each for Kosraean Association of Guam and Kosraean Association of Hawaii without having been provided any specifics on the benefits to be derived or the number of people who would benefit. Without specific information, Congress cannot assess how the Kosraeans living in Guam or Honolulu would benefit. See Appendix III for more information on the Kosrae Association of Hawaii on page 20.

Implementation Plans — An implementation plan is needed to explain how a project will be carried out to meet its objectives. However, almost 80 percent of CFSM projects proposals did not explain how the projects would be carried out. For example, while a project proposal to renovate the visitor facilities at a marine park included a detailed cost for materials, labor and overhead, there was no mention for how the renovation would be carried out. Without an implementation plan, Congress did not know that instead of obtaining competitive bids for the work to be performed, the project manager would purchase the materials himself and would hire

a local contractor for the labor. The material purchases ended up costing just 25 percent of the original material amount proposed, while labor costs were charged at over three times that which was originally proposed, raising a question on whether the renovation work was performed in accordance to what was originally proposed. See Appendix III for more information on the Utwe/Walung Marine Park Renovation on page 19.

Cause and Recommendations

Congress members did not follow selection standards used by other government entities because there was no requirement for CFSM public projects to meet the standards. Nor were there standards that a project proposal had to meet before it could be considered for selection as a CFSM public project. Additionally, Congress members did not involve State officials to jointly review or select public projects even when projects involved the State. Finally, the public law itself does not clarify the overall objectives that Congress wants to achieve regarding public projects intended for “social and economic development.” We indicated similar concerns in our previous audit of Yap CFSM projects.

We recommend that Congress:

- A. Define the term “social and economic development projects” in the CFSM appropriation law to provide sufficient guidance on how to determine what kind of project would qualify for CFSM funding. Furthermore providing a clear definition would correct what DOJ considered to be “defective” in the CFSM appropriation law in their legal opinion to ONPA.
- B. Adopt selection standards for the CFSM public projects similar to those commonly used by other agencies in the region.
- C. Adopt proposal standards in agreement with selection standards. The proposal standards would have to be met before the project will be considered for selection as a public project.

We recommend that the Congressional Members for Kosrae State:

Consider forming a committee, including members from the State Government, to review and assess public projects proposals to ensure they meet the selection standards and to recommend projects for CFSM funding. The committee should document their assessment for the public record. A more coordinated effort in planning and reviewing public projects can increase the likelihood that proposed projects are consistent with the State’s development plans and have the support and assistance of State resources if needed.

Prudent Management Practices Not Followed Resulting in Mismanaged and Misused Project Funds

Regardless of how a project was selected for funding, the FMR describes how public projects should be managed and implemented. However, FSM regulations and prudent government practices were not consistently followed in implementing public projects. We found inappropriate procurements, improper disbursements, and PCDs that were not sufficiently clear or complete to be able to relate expenditures to the project purpose. Finally, because of noncompliance with FMR, there is little assurance that project funds were safeguarded and properly accounted. As a result, we noted in some instances where project funds were mismanaged and misused.

Inappropriate Procurements — Project management officials did not follow the FMR in the procurement of goods and services for CFSM projects. As a result, unreasonable and excessive prices were paid and funds misappropriated or misused.

- **Mismanaged Procurement** — The FMR requires competitive bids and the awarding of the procurement to the lowest bidder for non-construction purchases of \$50,000 or more. While the Education Department correctly sought competitive bids, its selection method was not based on the lowest bid. Instead, the Department picked a supplier because it provided a parts warranty even though warranties were not mentioned in the request for bid proposals. Since the Department did not inform and allow other suppliers the same opportunity to offer a warranty, we believe the Department's selection was not conducted in a fair and equitable manner. This mismanaged procurement resulted in the Department paying 244 percent more than the lowest bid price of \$159,616. See Appendix III for more information on Kosrae Education Department – Classroom Furniture on page 15.
- **Overpriced Purchase** — Prudent government purchasing practice requires competitive price quotes for most purchases. The mayor paid \$3,500 for landfill materials without obtaining price quotes. We determined that the purchase price was 250 percent higher than the price from another quarry on the island (Note that the mayor purchased the materials from a quarry owned by a member of his own municipal council). As a result, the mayor paid \$2,100 more than if purchased at the other quarry. See Appendix III for more information on Existing Farm Road Improvement for Tafunsak Municipality on page 17.
- **Misappropriated Project Funds** — Funds should only be used for activities contained in the project proposal and approved by Congress. Funds used for purposes other than intended are considered misappropriated. Congress appropriated \$15,000 to a municipality for “Existing Farm Road Improvements.” However, the mayor used the funds to construct a new farm road on private property remote from any populated village or the paved main road. The funds for this new farm road appear to be misappropriated because the funds were not used for its intended purpose (i.e. “existing farm road improvements.”) See Appendix III for more information on Existing Farm Road Improvement for Tafunsak Municipality on page 17.

- **Questionable Contract** — The Contracts Act (55 FSMC § 401 to 418) specifies that contracts should describe the scope and nature of the work and the cost. However, the mayor of a municipality let a contract for \$10,000 that did not specify the length of road to be constructed, how it should be constructed, or other specifications for the work to be performed. State inspectors, also hampered by the lack of details in the contract, were unable to verify that the construction work done met any specifications and only reported on what they observed at the construction site. As a result, we question the sufficiency of the contract and the reasonableness of the contract price. See Appendix III for more information on Existing Farm Road Improvement for Tafunsak Municipality on page 17.

Improper Disbursements — The FSM Finance Field Office in Kosrae did not follow the FMR in disbursing funds for CFSM projects. As a result, over \$100,000 was improperly disbursed from the National Treasury.

- **Mismanaged Receipt and Payment** — The FMR requires that expenditures for supplies and equipment be supported by a signed receiving report. We found that the Department of Education did not follow the FMR in acquiring school furniture. Specifically, there was no contract or purchase order specifying the items ordered, the quantities, and the unit prices; no receiving reports were kept to document the quantities received; and the supplier invoices did not match the quantities or unit prices in the selected bid proposal. The result of this mismanagement led to the supplier receiving excess payments of \$38,584 above prices offered in its proposal. See Appendix III for more information on Kosrae Education Department – Classroom Furniture on page 15.
- **Improper Disbursement** — The FMR requires a written contract or valid obligation document before any disbursements can be made. The FSM Finance Field Office in Kosrae provided an advance of \$90,000 to the Public Utility even though an obligating document had not been executed. As a result, the funds have been residing in the utility company’s cash account since October 2005 and not accruing interest for the national treasury. See Appendix III for more information on Kosrae Utility Authority (KUA) – Extension of Power to Walung on page 16.

PCD Not Clear or Complete – The FMR and more specifically, the PCD under FMR Part X, section 10 is the governing document for all CFSM public projects. Before funds can be allotted, a PCD must be approved by the FSM Budget Office. The FMR (Part X section 10.2a) states that information in the PCD “should describe the project and its public purpose in sufficient detail to permit determination of legality of the proposed expenditures.” The PCD also should include benefits expected, project budget, funding source, and types of expenditures to be made, and whether the project conforms to National and State strategic development plans. The allottee signs the PCD certifying that the project will comply with all FSM regulations.

Of the 34 projects we reviewed, we found that the information in the PCD was not always sufficiently clear or complete, which hampered managing officials ability to properly assess, review, and approve project expenditures. In three of every four PCDs we reviewed, the information provided was not clearly written as to description of project or expected outputs, the implementation plan, or intended benefits. Nor was information sufficiently filled out in Part V

of the PCD regarding project justification and approval information. We reviewed PCDs for clarity and sufficiency and found that:

- 35 percent (12 of 34) did not have clear or sufficient description of project and purpose
- 65 percent (22 of 34) did not have clear or sufficient information on their implementation plan
- 76 percent (26 of 34) did not clearly identify benefits

The PCDs lack of clarity and completeness limited its usefulness as a guide for controlling and managing project costs. For example, in one project PCD that was not sufficiently detailed, we could not determine whether expenditures approved for payment were related to the activity outlined in its implementation strategy. Specifically, a Red Cross chapter indicated as its implementation strategy “train and register as many Kosraeans as possible to stand-ready for all emergencies and needed assistance in the State.” Of the \$5,000 of CFMS funds expended, \$2,211 was used for travel to attend a conference; \$1,277 was used for furniture and office supplies; and \$1,500 was used for fuel. Without clearer information on its implementation plan, we were unable to ascertain how the Chapter expenditures related to the project objective. See Appendix III for more information on Kosrae Red Cross Chapter Operations on page 19.

Cause and Recommendations

Appropriate management practices were not followed in implementing CFMS projects, because one sub-allottee, responsible for over 85 percent of the projects, was overextended in his oversight role, and responsible government officials did not ensure compliance with the FMR. We indicated a similar concern of noncompliance in our previous audit of Yap CFMS projects.

- The sub-allottee was overextended in his ability to provide effective oversight of the implementation and expenditures for projects assigned to him. The President (allottee) designated Deputy Assistant Secretary for Customs and Tax Administration (DAS CTA) in Kosrae, as the sub-allottee for 29 of 34 total projects under PL 13-36. He was also the designated sub-allottee for the majority of CFMS projects enacted in prior Congressional sessions,⁴ an unknown number of these projects remain open. Although this designated responsibility was in addition to his regular duties, no additional staffs were assigned to assist him.
- Although one of the duties of government officials is to provide oversight to ensure compliance with pertinent laws and regulations, the officials failed to ensure that FMR regulations were followed. Specifically, the allottee did not ensure that the PCDs were properly filled out; the FSM budget officer did not ensure the PCDs were clear and complete before making the funds available for use; and the allottee, the sub-allottee and FSM Finance officials did not ensure project expenditures complied with the FMR.

1. We recommend that Congress consider making the State Governor the allottee of all CFMS public projects in the State of Kosrae. The State Governor has resources to ensure adequate oversight and the implementation of the CFMS public projects.

⁴ Over 161 public projects for the State of Kosrae were enacted into law between the 10th and 13th sessions of Congress and passage of PL 10-120 through PL 13-36.

We recommend that:

2. The Governor require management officials of the Education Department and other state departments, and agencies to carefully review the FMR and provide signed certification verifying their thorough understanding of the provisions and requirements of the FMR.
3. The FSM Secretary of the DoF&A should:
 - A. Direct the FSM Finance Representative Officer in Kosrae:
 1. To follow FMR regulations to ensure all disbursements to the Kosrae State Government are made against only valid obligations under CFMSM projects;
 2. To ensure all disbursements of funds comply with the Financial Management Act of 1979, FMR, and all other policies and procedures of the National Government.
 - B. Consider removing from the roster of eligible allottees for CFMSM public projects, the DAS CTA. By removing his name from the roster, this current sub-allottee would not be further extended in his duties.
4. The FSM Budget Officer should ensure that PCDs are properly filled out before approving the advice of allotment that makes the funds available. Specifically, the FSM Budget Officer should:
 - A. Ensure that all information in the PCD is properly filled out and supported by appropriate documentation;
 - B. Ensure that information provided in the PCD is sufficiently detailed in describing project purpose, cost, and implementation strategy;
 - C. Ensure that part V (project justification and approval information) in the PCD is accurate, complete, and supported with documentation.

APPENDIX I: CFSM Public Projects in Kosrae with Amounts Expended

CFSM Public Projects pursuant to PL 13-36 as amended	Allottee	Amount Allotted	Amount Expensed/Obligated	Balance
A. Statewide Projects				
Kosrae Utility Authority-Power Extension to Walung	Governor	\$90,000	\$90,000	\$0
Department of Education - Classroom Furniture	Governor	50,000	50,000	0
Department of Health Services- Pharmaceuticals and Medical Equipment	Governor	50,000	45,541	4,459
Total for Statewide Projects		\$190,000	\$185,541	\$4,459
B. Municipal Projects				
Lelu Municipal Government				
Farm Road Maintenance	DAS CTA ^a	28,800	22,901	5,899
Contractual Services	DAS CTA	10,000	3,000	7,000
Youth Development	DAS CTA	1,200	1,100	100
Tafunsak Municipal Government				
Existing Farm Road Improvement	DAS CTA	15,000	13,500	1,500
Office Equipment and Supplies	DAS CTA	4,000	3,796	204
Office Renovation	DAS CTA	5,000	4,974	26
Lighting for Sport Facility	DAS CTA	5,000	4,823	177
Youth Center Renovation	DAS CTA	5,000	5,359	-359
POL (petroleum, oil and lubricants)	DAS CTA	1,000	1000	0
Malem Municipal Government				
Land Acquisition	DAS CTA	14,000	14,000	0
Site Development	DAS CTA	4,000	3,616	384
New Basketball Court	DAS CTA	10,000	10,000	0
Utwe Municipal Government				
Access Road	DAS CTA	15,000	15,000	0
Dump Site Improvement	DAS CTA	5,000	5,000	0
Drainage System	DAS CTA	5,000	5,000	0
Total for Municipal Government Projects		\$128,000	113,069	\$14,931
C. Other Organization Projects				
Kosrae Visitors Bureau	DAS CTA	7,000	6,732	268
Utwe/Walung Marine Park-Renovation	DAS CTA	6,500	5,283	1,217
Division of Women-Women's Center Renovation	DAS CTA	8,500	6,744	1,756
Kosrae Red Cross Chapter-Operations	DAS CTA	6,000	5,027	973
Department of Commerce & Industry-Consultant Fee for Self-Help Housing Project	DAS CTA	4,600	4,532	68
Health Services Department-Association of Pacific Nursing Leadership Council	DAS CTA	5,000	4,824	176
Pilyuul Youth Organization-Construction Materials	DAS CTA	1,400	1,353	47
Kosrae State Scholarships	DAS CTA	12,000	12,000	0
Kosrae Conservation and Safety Organization- Power Point Projector	DAS CTA	1,200	1,200	0
Kosrae Conservation and Safety Organization - Operations	DAS CTA	2,000	1,990	10
Lufwala Youth Organization-Equipment (Musical)	DAS CTA	2,800	2,800	0
Kosrae Association in Hawaii-Promotion of Community Relationships	Consul General Honolulu ^b	5,000	5,000	0
Kosrae Association in Guam-Promotion of Community Relationships	Consul General Guam ^c	5,000	5,000	0
United States Department of Agriculture-Rural Development-Travel	DAS CTA	5,000	4,323	677
Kosrae Island Resource Management Authority-Contractual Services	DAS CTA	7,000	5,500	1,500
Diabetes Today Program	DAS CTA	3,000	2,995	5
Total for Other Organization Projects		\$82,000	\$75,303	\$6,697
Total		\$400,000	\$373,913	\$26,087

Source: FSM Department of Finance and Administration reported as of 9/30/06

^a The FSM President (allottee) designated the Deputy Assistant Secretary of Customs and Tax for Kosrae as the Sub Allottee for these projects

^b The FSM President designated the FSM Consul General for Honolulu as the Sub Allottee

^c The FSM President designated the FSM Consul General for Guam as the Sub Allottee

APPENDIX II: Legal Opinion on CFSM Public Projects



DEPARTMENT OF JUSTICE

FEDERATED STATES OF MICRONESIA

P.O. Box PS - 105

Palikir, Pohnpei FM 96941

Phone: (691) 320-2608 / 2644 Fax: (691) 320-2234

October 16, 2006

Mr. Donald Yamada
Audit Supervisor
Office of the National Public Auditor
P.O. Box PS-05
Palikir, Pohnpei FM 96941

DOJ cited the heading "MLFC" by mistake. It should be CFSM Public Projects.

Re: Request for Legal Opinion on MLFC Audit and Investigation

Dear Mr. Yamada:

The Secretary has asked me to respond to your September 27, 2006 letter requesting our legal opinion on what the FSM Congress meant by the phrase "social and economic development projects" found in several sections of Public Law No. 13-36. As your letter suggests, the FSM Congress does not offer a definition of this phrase in P.L. No. 13-36, and with limited exception, does not provide any guidance on how to determine which social and economic development projects are appropriate uses of the funds appropriated pursuant to this law.

Unfortunately, nowhere in the Code of the Federated States of Micronesia is the phrase "social and economic development project" defined. Nor does the code provide general guidelines on how the allottee of such project funds is to determine whether a project qualifies as a social or economic development project – at least when the funds come from local revenue (in the case of Compact funds, such projects are governed by the provisions of the Fiscal Procedures Agreement). Historically, "social development projects" are typically, but not always, infrastructure development projects, while "economic development" projects are typically, but not always, private sector development projects. Moreover, it is not uncommon to find social and economic development project funds expended on the kinds of uses (*e.g.*, the purchase of vehicles, outboard motors, bags of rice, office supplies, etc.) that you list in your letter.

This is not to say that such a seemingly limitless interpretation of what constitutes a social or economic development project is in accordance with the law. We recommend that you review *Udot Municipality v. FSM, et al.*, 10 FSM Intrm. 354 (Chk. 2001), *aff'd*, *FSM, et al. v. Udot Municipality*, 12 FSM Intrm. 29 (App. 2003). Both the trial division and appellate division decisions are available on the FSM Legal Information website. Particularly relevant to your inquiry, the FSM Supreme Court enjoined the Executive from obligating or disbursing funds that were appropriated to an Election District in Chuuk

based, in part, on the findings that (1) the broad language of the appropriations law contained little guidance as to what specific projects were to be funded; and (2) there were no fair and transparent procedures to apply to the funds. Thus, arguably P.L. No. 13-36 is defective because it fails to specify the projects for which the funds are to be used or provide sufficient guidance on how to determine what kind of project qualifies for these funds.

Moreover, where the FSM Congress fails to specify the social and economic development projects funded by an appropriations law, Congress, or the Senators individually, cannot subsequently participate in the process of determining which projects to expend those funds on. As the Supreme Court held in the *Udot* case:

If Congress wishes to appropriate money for projects without designating by legislation the projects to be funded, it must then leave the administrative and executive decision-making as to which projects to fund to those whose duty it is to faithfully administer and execute the laws. Congress can give as much guidance as it wishes in the appropriation legislation about which projects will be funded, and much of this guidance will, no doubt, be the product of individual congressmen's consultation with their constituents. But this consultation takes place before the appropriation bill becomes law, not afterwards. After the appropriation bill has become law, it is the duty of those who execute the law and administer the funds to follow the guidance Congress has given them by consulting the language Congress put in the public law, and any applicable regulations, not by consulting individual congressmen. Congress may appropriate funds for specific improvement projects, or it may legislate rules for determining which projects are appropriate, or a combination of the two. What Congress, or individual congressmen, may not do is involve themselves in the administrative and executive process of determining which projects are to be funded after the money has already been appropriated.

While the appropriation of social and economic development project funds by state and election district has been common, this practice opens the door for violations of the type at issue in the *Udot* case to occur. When the allottee is given no legislative guidance regarding how money should be spent under a public law, there is no way for the allottee to ascertain how the funds should be used. Typically, election district staff provide the allottee with guidance on how the funds should be spent, but because the election district staff frequently communicate with the Senator for that district, the allottee has no way of knowing whether or to what extent a Senator was involved in making such requests.

Frequently, this Department raises the Supreme Court's findings in the *Udot* case when providing the President with legal sufficiency review of appropriations legislation transmitted by Congress for his signature into law. Sometimes, our concerns are included in the President's transmittal letter to the Speaker of the FSM Congress. However, rarely is a congressional act vetoed based on these issues alone. From a policy standpoint, it is

often perceived as inexpedient to veto the appropriations legislation, as Congress may simply override the veto in the subsequent session.

With regard to your inquiry as to what to do in the event that you find that an expenditure was an inappropriate use of social and economic development project funds, we recommend that you report such instances to the FSM Department of Finance, the Compliance Investigation Division in your Office and this Department. Together, we can then investigate the matter and determine the best way of retrieving the property at issue.

Please do not hesitate to contact us if you have any questions regarding the above.

Best regards,

A handwritten signature in black ink, appearing to read 'M. Olmsted', written in a cursive style.

Matthew L. Olmsted

Xc: Secretary, FSM Department of Justice
National Public Auditor

APPENDIX III: Project Description and Exceptions Noted for Selected Projects

Statewide Government Projects

1. Kosrae Education Department – Classroom Furniture

The Kosrae Education Department publicly solicited price proposals from suppliers to procure classroom furniture costing over \$300,000 (\$50,000 provided through CFSM funds). Instead of awarding the procurement to the lowest bidder, the Education Department based their selection on a parts warranty provided by one bidder. More specifically, we noted that:

1. Awarding a procurement based on a warranty (offered by one supplier) was an unfair contracting practice since the warranty was not solicited by the Department or required in the original request for bid proposals. Since other bidders were not given the opportunity to offer a warranty, the award became non-competitive with the appearance that the supplier selected was favored.
2. The Department selected a supplier whose prices were \$230,757 higher than that offered by the lowest bid supplier.
3. The bid opening was not open to the public, the winner was not publicly announced, nor were the losing bidders informed of the award decision. The award decision was kept private contrary to the proper handling for open bidding under the Purchasing and Contracts Act, (Part V, 5.2-5.9).
4. A contract was not signed as required by the Purchasing and Contracts Act for purchases of \$50,000 and above. Instead, an open purchase order was used that did not specify unit prices or quantities ordered.
5. An inspection was not performed on the furniture items delivered to insure order quantities and furniture specifications were met. Nor were there records of any delivery receipts for the furniture items received.
6. Payments checks to the supplier exceeded the cost of items ordered by \$38,584. The supplier received six payments totaling \$338,202 while the list prices offered in the supplier's bid proposal for the items received (3,250 desk/chair combination sets and 26 file cabinets) totaled \$299,618, an overcharge of \$38,584.
7. The Kosrae State Auditor's Office issued a report¹ on the DOE furniture procurement citing an overpayment of \$38,864² made to the supplier. The report also cited that the award was not competitively bid; that delivered furniture items did not meet proposed specifications; and that a contract was not used contrary to financial regulations.
8. Table 1 shows the total proposal prices submitted by five suppliers. Vendor 4 was awarded the procurement.

Table 1: Price comparison of vendor proposals for classroom furniture

Bidders	Vendor 1	Vendor 2	Vendor 3	Vendor 4	Vendor 5
Total Price	\$159,616	\$381,253	\$383,996	\$390,373	\$424,395

Source: Office of the National Public Auditor's review of furniture bid documents

¹ Kosrae State Public Auditor report on Department of Education: Procurement of Furniture and Fixtures, Audit Report No. AE001-07 dated April 19, 2007.

² The calculated overpayment figure differs from National Public Auditor's figure by \$280 because a price adjustment for one furniture item was not included in the State Auditor's calculation.

2. **Kosrae Health Services Department – Pharmaceutical and Medical Equipment**

The Health Department Director requested Congressional assistance to provide extra collateral (\$50,000 cash) to the Department's health care revolving account to ensure approval and servicing of a proposed USDA Rural Development loan. The USDA loan for \$430,800 to purchase medical equipment was approved in late 2006 and plans were going forward to use the loan to purchase the medical equipment as intended. However, we noted:

1. The Department used the \$50,000 CFMS funds in its revolving account to purchase drugs and supplies for the hospital rather than restrict its use for servicing the USDA loan.
2. The repayment schedule on the \$430,800 loan will amount to \$3,268 a month over 15 years to be secured and paid from the Department's health care revolving account. The Director assured us that the revolving account would have sufficient funds available to service the monthly loan payments. We did not review the health care revolving account or assess the Hospital's cash flow to determine whether the Hospital can meet its loan repayment schedule.

3. **Kosrae Utility Authority (KUA) – Extension of Power to Walung**

The KUA estimated the costs to extend electrical power to a remote village (Walung) would be nearly \$159,000, of which \$90,000 was secured from Congress with the remaining \$69,000 to be funded from the Kosrae State Government. The project has yet to be implemented due the lack of infrastructure funds to repair and improve the road on which KUA will use its heavy equipment. There is no estimate of when the road construction will begin or when additional funds will be available. Exceptions and observations noted were:

1. An advance was released to the utility company ahead of any agreement, contract, or other obligation document contrary to the FMR requiring an obligating document prior to the release of funds.
2. The advance for the 100 percent of the appropriated amount (\$90,000) was released exceeding the 15 percent authorized for construction contracts under FMR.
3. Over the past two years (since October 2005) the funds have been sitting in KUA's cash account and not accruing interest for the National Treasury.

Municipal Government Projects

4. **Farm Road Maintenance for Lelu Municipality**

Congress appropriated \$28,800 to the Lelu Municipal Government for existing farm road maintenance. The Municipality had its own heavy equipment (2 dump trucks, 1 excavator, and 1 front-end loader) and employed its own equipment operators for use on municipal projects including farm road maintenance. The Municipality also used its heavy equipment and operators to generate revenue from job orders received from individuals, businesses and other municipalities who were charged equipment rental fees. We noted the following exceptions:

1. The Municipality expended \$7,748 of the \$28,800 appropriated by Congress on consumable items like fuel, oil and lubricants and equipment parts.
 - We were unable to determine whether the expenditures for fuel and other consumables were used strictly on farm roads project since the fuel was purchased

in bulk barrel drums and there was no separate accounting for fuel and oil consumed on individual projects.

- The Municipality did not separately account for the equipment operating cost on individual job orders so operator wages, consumable fuel and oil, and repair and maintenance costs were not clearly delineated between municipal projects and its revenue-generating equipment rental business.
 - The Municipality used its equipment and operators more frequently on job orders that generated rental fees than on farm road maintenance. From the beginning of 2006 through the first quarter of 2007, the Municipality completed 40 job orders that earned \$5,020 in assessed rental fees while during the same period just three job orders for farm road maintenance were performed.
2. We believe that the funds expended on fuel and other consumables were used for other purposes than for farm road maintenance including fuel used in the Municipality's revenue-generating equipment rental business.
 3. We question whether CFSM funds should be used to fund the municipality's operations of its heavy equipment used for both municipal projects and to generate revenue from equipment rental fees.

5. **Contractual Services for Lelu Municipality**

Lelu Municipality received \$10,000 funds for contractual services to be used for technical, legal, or professional services. After two years when no contractual services were used, the mayor requested a change to the project PCD (approved by the sub-allottee) to include "beautification services" involving general cleanup along the roads for trash collection, vegetation clearing and disposal to the dumpsite. We noted the following exceptions:

1. The mayor issued six job orders of \$500 each (\$3,000 in total) to six individuals for the cleanup work. The job order cost breakdown of the \$500 specified 50 workers at \$2.50 per hour for 4 hours. The job orders did not specify the timeframe to complete the road cleanup, nor specify the locations for the work to be performed. However, all six-job orders were issued on the same day. We were unable to determine whether the extent of work performed was reasonable for the amount paid.
2. The change of project scope from using professional and skilled labor to include unskilled labor for road cleanup raises the question on whether the original project scope was needed and whether the change in project scope should have been allowed.

6. **Existing Farm Road Improvement for Tafunsak Municipality**

Congress appropriated \$15,000 for the Tafunsak Municipality to use on existing farm road improvement. Instead of using the funds on existing farm roads, the mayor hired a contractor to construct a new farm road on private land, remote from the island's main paved road and away from populated areas of Tafunsak proper. We noted the following exceptions:

1. A \$10,000 farm road contract, signed by the FSM Attorney General's Office, did not include specifics on the amount of work to be performed, such as the length, width, and composition of the farm road, nor the amount of clearing, drainage or backfill materials needed, or even the specific location. Instead, the contract only specified that \$10,000 would be paid to the contractor for construction of a farm road in the municipality (at Okat) to be completed by the end of March 2006.

2. Instead of going out for bids as indicated in the project's PCD, the mayor selected a contractor without competition. Additionally, the contractor did not provide a construction proposal, or cost estimate of what it would cost per square feet to construct the farm road.
3. The farm road is located on private land, yet, there were no records of any easement or such document allowing public access to the road. Nor was there any environmental impact report or engineering assessment made on the road.
4. Inspectors from the Division of Construction & Engineering reported in their two inspection reports that they did not receive information about the contractor's scope of work, or length of road to be constructed. They reported on only what they observed at the road site.
5. The mayor purchased \$3,500 worth of landfill for the road's sub-base from a quarry owned by a member of the municipal council at a unit price 250 percent higher or \$2,100 more than from another quarry on the island. Since the scope of work (length of road and thickness of landfill material needed) was not clearly defined, we were unable to substantiate the reasonableness of the volume of landfill materials purchased.

7. **Land Acquisition for Malem Municipality**

Congress appropriated \$14,000 to the Malem Municipality to acquire land for a playground project. Exceptions and observations noted were:

1. The mayor's request to purchase land to extend an existing playground included only the dollar amount to be expended and did not include any details as to the specific location, the size of property, or the basis for the land value/price to be paid.
2. The two adjoining parcels of land subsequently acquired by the Municipality were purchased at prices 500 to 800 percent higher than surrounding land values.
 - Property acquisition regulations (56 FSMC §201-209), states that real property should be appraised for fair market value and a just compensation amount established before negotiations are initiated.
 - Figures computed for land valuations in Kosrae from FSM Economic Affairs (Land Administration and Management Project) indicated that prices for the respective zone 51 in Malem (location of the playground) are between \$2.00 and \$2.50 per square meter. This valuation was confirmed by the State Kosrae State Audit Office.
 - Prices paid for the two land parcels amounted to \$18.32 per square meter (\$5,000 purchase price for 273 square meters) and \$10.99 (\$9,000 for 819 square meters).
 - The owner and seller of one of the two land parcels (for \$5000 at \$18/sq meter) was the Chairman of the Malem Municipal Council. The relationship between the Mayor and the Council Chairman raises the question of whether the prices paid for the land acquired was fair and reasonable.

8. **Funding for Utwe Municipality**

Congress appropriated \$25,000 to the Utwe Municipality for constructing access roads (\$15,000), improvement of a municipal dumpsite (\$5,000), and for a drainage system (\$5,000). The exceptions noted were:

1. Instead of a separate PCD to explain the purpose, benefits, and implementation of each project, only one PCD was submitted for all three projects providing only a broad and unspecified description of the work to be completed without clearly distinguishing between the three projects.
2. One Advice of Allotment was issued by the FSM Budget Office for the total amount of \$25,000 to cover the three projects.

Other Organization Projects

9. **Utwe/Walung Marine Park Renovation**

Congress appropriated \$6,500 for the renovation and improvement of the Utwe/Walung Marine Park. The park manager hired a contractor to renovate three picnic huts, one traditional hut, and provide general maintenance while purchasing the materials himself. Exceptions and observations noted were:

1. The initial request to Congress members included a cost estimate for labor at \$1,420 and for materials at \$7,235. Although \$6,500 of this amount was funded, actual expenditures amounted to \$4,500 for labor that was 3 times the initial labor cost and \$1,783 for materials, or only 25 percent of the materials initially proposed.
2. Comparing actual invoices of material items purchased to the original listing of materials needed for the renovation, we could trace only the plywood sheets (\$144), and lumber (\$285) as common items actually purchased.
3. The project was not inspected by the designated inspecting official (Division of Construction and Engineering). Instead, the Park manager indicated in a payment request letter that an inspection was done by the sub-allottee. However, there was no inspection report signed or filled out by the sub-allottee.
4. The discrepancy between the labor and materials expended with what was initially proposed for the renovation raised a question on the level of effort and reasonableness of the costs. Additionally, a dispute between the Park manager and the contractor over payments received for work performed raised further questions on the project's appropriate costs.

10. **Kosrae Red Cross Chapter Operations**

Congress appropriated \$6,000 to the Kosrae Red Cross Chapter without specifying how the funds should be used. Subsequently, the Red Cross Chairman submitted a PCD with the objective of providing "emergency aids to the community and to villages" and more specifically, to "train and register as many Kosraeans as possible to stand-ready for all emergencies and needed assistance in the State." The Red Cross Chapter expended more than \$5,000 in fiscal year 2005. Nearly 45 percent of that amount was expended for travel by the Chairman and the Coordinator to a conference in Pohnpei. Subsequently, the Coordinator moved to Hawaii and the Kosrae Red Cross Chapter ceased its operations. Exceptions and observations noted were:

1. Invoices of over \$1,500 were submitted for fuel, exceeding the \$500 budget for fuel in the Chairman's request letter to Congress. The review of sales receipts revealed that four fuel purchases made during the holidays, i.e., 12/30/04, 1/4/05, 1/5/05, 1/10/05. The sub-allottee questioned (disallowed) one receipt because of the consecutive dates of two receipts.
2. The other expenditures included \$1,276.73 for furniture (executive chair, filing cabinet and other supplies).
3. Because the Red Cross Chapter had shut down its operations, we were unable to obtain any records to indicate the kind of activity the Red Cross conducted. Therefore, we were unable to assess the relevancy of the expenditures to the objectives identified in the PCD.

11. **Kosrae State Scholarships**

While Congress appropriated \$12,000 for scholarships for Kosrae students, we noted the subsequent scholarship awards to four students were not sufficiently documented to determine how the Scholarship Board members selected its award recipients or whether the board followed its own guidelines in the selection process. We noted further that:

1. The board minutes prepared by the scholarship administrator listed the four award recipients and the amount of awards for each student, but the minutes were not signed by any board member.
2. The administrator's scholarship files did not contain any documents indicating board members reviewed the student applications, or approved the students selected for award.

12. **Kosrae Association of Hawaii**

Congress appropriated \$5,000 to the Kosrae Association in Hawaii (KAH) for promotion of community relations. As of 9/30/06, the amount had been obligated according to FSM Finance records, however, no expenditures for actual payments has been made. Although we attempted three times to contact the sub-allottee (Consulate General in Hawaii) to inquire about the obligated funds, the Consulate General has not acknowledged our inquiries.

NATIONAL PUBLIC AUDITOR'S COMMENTS

We wish to thank the staff of the DoF&A, Kosrae Congressional Delegation Office, Chief of Engineering Division Kosrae State, Kosrae State Department of Education, State Department of Health, FSM CTA in Kosrae and FSM Finance Field Office in Kosrae, Kosrae Utility Authority, and the municipal governments for Lelu, Tafunsak, Malem and Utwe for their assistance and cooperation during our review.

In conformance with general practice, we provided a copy of the draft report to the President, Vice President, the Chairman of Kosrae Congressional Delegation, the Governor of Kosrae, and the FSM Secretary of DoF&A for their review and comments. We did not receive any written comments to be included in this report.

In addition to providing copies of this report to the President, Vice President and Members of the 15th Congress, we also sent copies to the Governor and Lieutenant Governor of the State of Kosrae, Speaker and Members of Kosrae State Legislature, DAS CTA for Kosrae, the Kosrae Congressional Delegation, FSM Budget Officer, Mayors and Council Members of Kosrae Municipal Governments, Director of Education for Kosrae, Director of Health for Kosrae, Board Chairman for Kosrae Red Cross, Kosrae Utility Authority, Engineering Division for Kosrae State, Department of Foreign Affairs, FSM Consulates in Honolulu and Guam, Kosrae State Audit Office, and Chief Justice and Associate Justices of the FSM and Kosrae State Governments. We will make copies available to other interested parties upon request.

If there are any questions or concerns regarding this report, please do not hesitate in contacting the office. Contact information for the Office can be found on the last page of this report, along with the National Public Auditor (ONPA) and staff who made major contributions to this report.



Haser H. Hainrick
National Public Auditor

October 29, 2007

ONPA CONTACT AND STAFF ACKNOWLEDGEMENT

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In addition to the contact named above, the following staff made key contributions to this report:

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