OFFICE OF THE NATIONAL PUBLIC AUDITOR

FEDERATED STATES OF MICRONESIA

AUDIT OF CHUUK STATE DEPARTMENT OF HEALTH SERVICES' PROCUREMENT AND INVENTORY MANAGEMENT SYSTEM (FY 2006-2008)

REPORT NO. 2010-03

Haser H. Hainrick

National Public Auditor

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FEDERATED STATES OF MICRONESIA
Office of The National Public Auditor
P.O. Box PS-05, Palikir, Pohnpei FSM 96941
Tel: (691) 320-2862/2863; Fax: (691) 320-5482;
CID Hot Line: (691) 320-6768; E-mail: hhainrick@fsmopa.fm

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His Excellency Manny Mori, President
Honorable Members of the FSM Congress
Federated States of Micronesia

RE: Audit of Chuuk State Department of Health Services' Procurement and Inventory Management System

We have completed an audit of the Chuuk DHS' procurement and inventory management systems for FY 2006 – 2008. The purpose of the audit was to determine whether procurement funds were used efficiently and effectively to ensure that medications were available on the outer islands. We conducted this audit in accordance with Generally Accepted Government Auditing Standards.

The results of the audit revealed that DHS has not been effective in ensuring that medications are available at the outer island dispensaries. The audit also revealed that DHS has not implemented an adequate inventory management system and, as a result, funds were not used efficiently. An effective system would have resulted in better results at a reduced cost.

The audit team traveled to six of the 78 (8%) outer island dispensaries and found that on average the dispensaries lacked 19 of 33 (56%) of medications considered essential[1]. Health assistants who staff the outer island dispensaries lack the medical knowledge to determine whether deaths that occurred could have prevented by the availability of the needed medications. However, the health assistants reported several specific deaths in which the lack of needed medications may have been a contributing factor. The report cites five specific areas in which better management and oversight of the inventory and distribution functions would improve the availability of medications on the outer islands.

The audit also revealed that medications in both the hospital warehouse and the island dispensary inventories were expired. About 15% of the medications at the warehouse were expired. On average, 27% of the medications on the outer island dispensaries were expired. Better inventory

[1] Chuuk DHS developed a list of essential medications based on a World Health Organization listing for this region.

management practices are needed to ensure that expired medications are removed and not given to patients.

Several problems in the area of procurement were also revealed during the course of the audit. Approximately $700,000 in advance payments were made to offshore vendors who never supplied the pre-paid merchandise. Because DHS officials did not monitor the status of the pre-paid items, no effort was made to obtain either the goods. In other instances conflicts of interest occurred when medications and supplies were purchased from vendors related to DHS and DAS officials involved in the procurement process. Moreover, emergency declarations were used to bypass procurement bidding requirement in some instances and in other instances DHS did not comply with procurement requirements.

Audit analysis also revealed that a lack of controls over fuel purchases resulted in a 70% increase in fuel spending during the two-year period reviewed. Because record keeping was lax, fuel use cannot be accounted for. For example, a $19,000 payment was made to a fuel vendor in June 2008 however there are no records to document whether the fuel was received or how it was consumed. The audit team was able to confirm that some fuel intended for the hospital generator was diverted to other Chuuk State departments and agencies and that DHS was not reimbursed for the fuel.

The ONPA discussed the contents of the report with officials from DHS, DAS, and the Compact Funds Control Commission (CFCC) and provided them with draft copies of the report. The organizations were asked to provide written comments which are included as an appendix to the attached report. In general, all three parties agreed with the report findings and resulting recommendations. Their responses provide the details of how they plan to address the issues discussed in the audit report.

Respectfully yours,

Roger Hainrick
National Public Auditor

TABLE OF CONTENTS

INTRODUCTION 1
Background 1
Procurement Process 2
Essential Medicine List 3
Prior Audit Coverage 4
Objectives, Scope, and Methodology 4
Conclusions 5
FINDINGS AND RECOMMENDATIONS 7
1. Non-Availability of Medications at the Dispensaries Resulted in Denial of Treatments and Possibly Deaths 7
Causes and Recommendations 10
2. Expired Medicines Included in the Inventory 14
Causes and Recommendations 14
3. Medicines Purchased From Immediate Family Members of DHS Officials and Staff 16
Cause and Recommendations 18
4. Approximately $700,000 Worth of Purchased Medications Not Received 19
Causes and Recommendations 20
5. Unsound Procurement Practices Likely Circumvented Competitive Procurement Requirement 22
Causes and Recommendations 27
6. Absence of Accountability and Poor Inventory Management Led to Various Inefficiencies 28
Causes and Recommendations 30
7. Lack of Control Over Fuel Purchases Resulted in 70% Increase in Fuel Spending During Two Year Period 33
Causes and Recommendations 36
8. Lack of Accountability Led to Questionable Use of Revenue Funds 40
Causes and Recommendations 42
Appendix A - Flowchart of the Procurement Process 45
Management Response from DHS 46
Management Response from DAS 49
Management Response from CFCC 53
ONPA EVALUATION OF MANAGEMENT RESPONSE 55
NATIONAL PUBLIC AUDITOR'S COMMENTS 57
ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS 58

INTRODUCTION

Background

The state of Chuuk consists of three distinct areas: Weno, the lagoon islands, and the outer islands. Weno, the administrative center and capital of Chuuk, is home to approximately 13,900 residents (2000 census[1]). Inside of the lagoon, which is approximately 40 miles in diameter, are 11 mountainous islands and numerous islets. These islands are within a one to three hour boat ride of the Chuuk State Hospital on Weno. Approximately 40,465 people live on the lagoon islands.

The other area, normally called the outer islands, are the Mortlock and Northwest regions. These outer islands are much farther from Weno. Approximately 13,130 people live on the outer islands and travel to Weno can take from one day to two days by boat. Additionally, the Caroline Island Air (CIA) provides roundtrip flights to Ta, Houk, and Onoun islands in the outer islands. The CIA flight services are not regular and occur only when a sufficient number of seats are sold. During FY 2008, there were nineteen regular flights and six charter flights to Ta island, four regular flights to Houk island and one flight to Unoun island.

Each outer island has a health dispensary facility, which is staffed by one or two Health Assistant. The dispensaries provide primary health care services including acute care services for basic ailments.

The Chuuk State Department of Health Services (DHS) was established under Article X Sections 6 and 7 of the Chuuk State Constitution. The Constitution mandated that the State Government shall provide for the protection and promotion of health, and shall ensure, within the limits of its resources, that no person is discriminated against in the distribution of medical care, or is refused medical care because of that person's inability to pay. The DHS mission is to promote and maintain a holistic system of health care that will improve the health and longevity of the people's lives. In order to achieve its mission, DHS established two strategic goals: 1) improve primary and secondary health services and 2) develop a sustainable health care financing mechanism.

DHS's operations are fully funded by Compact Health Sector (CHS) grant provided by the U.S. Department of Interior. The DHS operates with an annual procurement budget of more than $3,000,000. Medications and medical supplies are accounted for in the budget category "Other Current Expenses." This budget category, which accounts for almost half of the Department's budget, includes pharmaceutical and medical supplies, as well as utilities, fuel, office supplies, repairs, and other expenses that are not included in the other five budget categories.

Table 1 documents the procurement budget allocations by category for fiscal years 2006 – 2008.

[1] Latest census available at Chuuk State

Table 1
DHS Procurement Budget FYs 2006-2008

Budget Line Item	Budget		
	2006	**2007**	**2008**
Other current Expenses	2,237,755	2,803,400	3,221,769
Contractual	302,004	386,461	573,228
Fixed Asset	318,743	0	68,496
Authorization[2]	790,884	0	
Total	**3,649,386**	**3,189,461**	**3,863,493**
Source: Chuuk Department of Administrative Services			

DHS has 439 employees, including the Director and the Deputy Director. The DHS is composed of seven Divisions: Health Services, Hospital Management and Administration Services, Dispensary, Nursing, Sanitation, Dental, and Public Health/Communicable Disease. A Chief heads each of these divisions.

The Division of Hospital Management and Administration is responsible for procurement activities, including the procurement of medicine. Within the Division, the Storeroom and Administrative Section, which is staffed by a Procurement Officer and three supply technicians, is responsible for procuring and receiving medicines, maintaining the storeroom and for related accounting and inventory functions. Specific tasks include determining needed goods, identifying potential suppliers, requesting bids/quotations, evaluating the received bids/quotes, negotiating with the potential vendors, and then awarding a contract. The DHS Director must then approve the contract, as evidenced by his signature on a Purchase Requisition (PR).

Procurement Process

The process requires that the approved PR and the bids/quotes be forwarded to the Department of Administrative Services (DAS) Fund Control Section, which then must certify that funds are available. If Compact funded, the PR is also forwarded to the Chuuk State Compact Funds Control Commission (CFCC), which must review and approve all compact-funded transactions. The PR must also be approved by the DAS Director and then by the Governor (allotee), if over $10,000, for final approval.

The approved PR is returned to the DAS Funds Control Section, which then prepares a Purchase Order (PO). The PO must then be approved by the DAS Chief of Finance. The PO is then submitted to the vendor.

[2] Authorization – is a "catch all" budget category for items not included in the other categories. Allotments under this object class are released by Chuuk State Finance upon request without the restrictions normally exercised on other disbursements.

When the goods are delivered, representatives from CFCC (if Compact funded), the DHS Storeroom and Administrative Section, and the DAS Supply & Procurement Section, are responsible for inspecting and counting the items and verifying that the delivered items agree with the corresponding PO in terms of specifications, price and quantities. The process requires that their review be documented by preparing and signing an inspection report after the count. At the same time, the DAS Procurement & Supply Section prepares a "Supply Transaction Document" (equivalent to a receiving report (RR)) to document the receipt.

Appendix A (page 45) contains a flowchart of the procurement process.

The dispensary storeroom under the Dispensary Division is responsible for distribution of medicines and medical supplies to the dispensaries. The Dispensary Division is headed by a Chief of Dispensary and assisted by a storeroom technician. The Chief of Dispensary manages the operations of the Dispensary Division. One of his major duties/responsibilities[3] is the responsibility for providing medical supplies and medications in terms of timely procurement and allocation of medications to dispensaries. The Chief of Dispensary is also responsible for the development and implementation of dispensary policies, procedures, programs, activities and improvements in the dispensary infrastructure.

The storeroom technician is responsible for receiving goods from the hospital warehouse and issuing goods to the dispensaries. The storeroom technician is also responsible for being aware of when the storeroom inventory needs to be replenished and for requesting those items from the hospital warehouse. If the hospital warehouse does not have the requested items in stock then the storeroom technician prepares a purchase requisition through the Dispensary Chief and submits it to the Procurement Officer at the DHS Storeroom and Administrative Section. When health dispensaries run low on medications, the dispensary health assistants radio in their requests and wait for the next available field trip ship to deliver to them or the health assistants travel to Weno to get the needed medical supplies.

Essential Medicine List

Essential Medicines, as defined by the World Health Organization (WHO) are "those drugs that satisfy the health care needs of the majority of the population." The WHO further states that "they should therefore be available at all times in adequate amounts and in appropriate dosage forms, at a price the community can afford."

The WHO has published a model list of essential medicines. They are selected with due regard to public health relevance, evidence on effectiveness and safety, and comparative cost-effectiveness. However, since medical needs differ from country to country and island to island, countries are encouraged to prepare their own lists taking into consideration local

[3] These basic duties were based on interview with the acting Chief of Dispensary. There is no written job description of this position on file either at Personnel or Dispensary Division.

priorities and conditions. Chuuk State adopted its own list referred to as the "Dispensary Essential List of Medicines."

Prior Audit Coverage

This is the first ONPA audit of the DHS procurement and inventory function. We reviewed the prior single audit reports for fiscal years 2006 to 2007 issued by Deloitte and Touché LLP to determine findings that were relevant to our audit objectives. We identified four findings that were relevant to our audit objectives as follows:

- Management utilization of emergency declarations to circumvent competitive procurement
- Inadequate supporting documents
- No documented rationale for the selection of vendor, and
- Lack of applicable contract provisions

OBJECTIVES, SCOPE, AND METHODOLOGY

The objectives of this audit were to determine whether the DHS implemented an effective procurement and inventory control system, efficiently used procurement funds, and ensured medications were available on the outer islands.

Specifically, the audit was designed to answer the following questions:

1) Has DHS ensured that essential medications and supplies are readily available at outer island dispensaries?
2) Are procurement functions performed efficiently, effectively, and in compliance with regulations?
3) Do inventory management practices ensure medications and medical supplies are safeguarded against theft, waste and abuse?

Our audit covered the transactions for fiscal years 2006, 2007 and 2008 and the inventory management conditions existing in March, 2009. We conducted our fieldwork at the DAS and DHS offices. We also visited six health facility dispensaries at the outer islands. The audit was conducted pursuant to Title 55 of the 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."*

We conducted this performance audit in accordance with generally accepted government auditing standards, which was issued by the U.S. Government Accountability Office on July 27, 2007. Those standards require that we plan and perform the audit to obtain sufficient and appropriate evidence to provide a reasonable basis for our findings and conclusions based on

our audit objectives. We believe that evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We gained an understanding and made an evaluation of internal control procedures that are significant within the context of our audit objectives. Deficiencies noted in internal control procedures that resulted from this evaluation are addressed in the body of this report along with resulting recommendations.

To determine whether essential medications and supplies are readily available, the audit team conducted site visits at six outer island dispensaries. The audit team conducted inventories of the medication supplies on the islands and interviewed the health assistants responsible for providing medical care. The team also interviewed health assistants from other islands when those assistants were on Weno.

To determine whether procurement functions performed efficiently, effectively, and in compliance with regulations, the team interviewed the appropriate staff and officers from the DHS, DAS, as well as other stakeholders. The audit team also tested a sample of transactions relating to the authorization and approval of transactions; the requisition, obtaining bids/price quotations, ordering, inspecting and receiving of goods; and the issuance of payment. Documents such as allotments, purchase requisitions, purchase orders, contracts, miscellaneous payments, receiving reports, supplier invoices, payable vouchers, check vouchers, distribution slips and other supporting documents were reviewed.

To determine whether inventory management practices ensure resources are safeguarded against theft, waste and abuse the audit team reviewed inventory management practices at the central warehouse, inspected the warehouse, and conducted inventories of the supplies and medication.

We also designed procedures to provide reasonable assurance of detecting fraud, illegal acts, non-compliance and abuse. We referred likely cases of fraud, illegal acts, or abuse to the National Public Auditor's Compliance Investigation Division for further review.

CONCLUSION

We concluded that the Chuuk State DHS did not implement an effective procurement and inventory control system that would help ensure the efficient use of procurement funds and the timely distribution of medications to intended recipients.

The DHS did not ensure that the essential medications and supplies are readily available. We found that the non-availability of essential medications at the island dispensaries resulted in denial of treatments and may have contributed in unnecessary deaths.

We also found that the procurement functions were not performed efficiently, effectively, and in compliance with regulations. We found cases of unsound procurement practices that likely circumvented competitive procurement requirements. For example, we noted cases of false or questionable quotations that were attached to purchase orders and we noted that some purchases were not approved or adequately supported. Furthermore, we found cases of medications that were purchased from immediate family members of DHS officials and staff in violation of the regulations on conflict of interest. Lastly, we found that approximately $700,000 worth of purchased medications paid in advance was never received by the DHS.

Moreover, we found that the inventory management practices did not ensure that resources were safeguarded against theft, waste and abuse. For example, we noted the absence of accountability and poor inventory management led to various inefficiencies. In addition, we found that large inventory of expired medicines was included in DHS's inventory of medications.

Lastly, we found that lack of controls resulted in unnecessary increase in fuel spending and the absence of transparency and accountability led to questionable use of the income earned from revenue generating activities of the DHS.

Specific findings and recommendations are discussed in the following pages:

FINDINGS AND RECOMMENDATIONS

1. Non-Availability of Medications at the Dispensaries Resulted in Denial of Treatments And Possibly Deaths

The ability to provide basic medical care requires that necessary medications are available and accessible to the population. For this purpose, the Chuuk State DHS developed the "Dispensary Essential List of Medicines" which identified the medicines that should be available at the dispensary health facilities for basic health care services. It aims to list the most effective, safe, and economical medicines for priority conditions. Priority conditions are selected based on current and future public health relevance and potential for safe and cost effective treatment. The DHS Dispensary Essential List of Medicines is based in part on the World Health Organization's (WHO) Essential Medicine List, 15th Edition of March 2007.

We found that the outer island dispensaries lacked many of the essential medications and supplies. The audit team performed inventory counts at eight percent (6 of the 78) of the outer island dispensaries and found that on average the dispensaries lacked 56 percent (19 of the 33) of the essential medications. Each dispensary was without at least 15 of the 33 essential medicines and one dispensary was missing as many as 24 of the 33. Furthermore, 11 specific medications were not available on any of the six islands.

The outer islands inventoried by the audit team and the number of essential medications not available on each island are presented in Table 2 below.

Table 2
Essential Medications Not Available On Outer Islands

Island	Essential Medications Available	Essential Medications Not Available
Moch	9 (27%)	24 (73%)
Oneop	14 (42%)	19 (58%)
Ta	14 (42%)	19 (58%)
Lekinioch	15 (45%)	18 (55%)
Satowan	17 (52%)	16 (48%)
Kuttu	18 (55%)	15 (45%)

Source: ONPA inventory count conducted April 2009

Note: Audit analysis of inventory count at the dispensaries. The 33 total types of essential medicines were established by counting the medicines in the "List of Essential Medicines" by type. Medications that had expired were not considered by the audit team to be available.

Additionally, health assistants from six islands not visited by the audit team were interviewed while the health assistants were on Weno. These health assistants reported that their dispensaries also lacked many essential medications.

Many of the essential medicines not available at the dispensaries are needed to combat routine and expected health threats. For example, glyburide, a drug used to treat diabetes, was not available at the dispensaries located at Kuttu, Lekinioch, Moch, Oneop, Satowan, and Ta islands. Table 3 below shows examples of essential medicines that were not available in the islands' dispensaries and the ailments and illnesses the medications treat.

Table 3
Partial Listing of Essential Medicines Not Available

Dispensary	Essential Medicines Lacking	Ailments and Illnesses Treated
1. Kuttu	Glyburide	Diabetes
	Sulfamethoxazole	Ant-bacterial
	Sulfacinamide/Tetracycline	Antibiotic for eyes
2. Lekinioch	Cortisporin	Antibiotic
	Sulfacinamide/Tetracycline	Antibiotic for eyes
	Glyburide	Diabetes
3. Moch	Glyburide	Diabetes
	Cortisporin	Antibiotic
	Albuterol	Asthma
4. Oneop	Glyburide	Diabetes
	Cortisporin	Antibiotic
	Captopril/Hydrochlorodiazide	High Blood Pressure
5. Satowan	Albuterol	Asthma
	Glucose	Diarrhea
	Glyburide	Diabetes
6 TA	Acetlysalicylic Acid/Paracetamol	Pain killer, Fever Reducers, Anti Swelling
	Diphehydraminate	Can prevent death from allergy
	Ranitidine	Anti ulcer
	Glyburide	Diabetes

Source: ONPA dispensary inspection

It should be noted that while the dispensaries lacked many of the essential medications, other medications not classified as 'essential' were available. Additionally, essential medications that had expired were often retained though standard medical protocol prohibits the use of expired medications. The power of the medication weakens over time and the purpose of the expiration date is to let people know when the medicine is assumed to have lost its power.

Table 4 on the following page documents the non-essential medications and expired medications found at the dispensaries.

Table 4
Non-Essential and Expired Essential Medications at the Dispensaries

Island	**Non-Essential Medications Available**	**Expired Medications****
Kuttu	52	13
Lekinioch	30	21
Moch	26	19
Oneop	30	16
Satowan	31	14
Ta	40	8

Source**:** ONPA inventory count conducted April 2009
** Consisting of Essential and Non-Essential Medications

Because of the lack of essential medications, appropriate health services were not always provided. We are unable to quantify these cases. Though not qualified to make an assessment as to the cause of death of a patient, the health assistants on several of the islands reported incidences when the lack of needed medications and supplies may have contributed to unnecessary death of patients.[4]

The 12 heath assistants reported that the following occurred on their islands[5]:

- On one island a patient died of Hepatitis B and another of Dengue Fever when the needed medications were not available.
- On another island one patient died of Hepatitis B and another of Diabetes when the needed medications were not available.
- On two separate islands patients died of kidney infections when the medications were not available.
- An infant died when a sick mother could not breastfeed and the dispensary did not have infant formula.
- A newborn baby died when the health assistant did not have a thermometer and was not aware of how high the baby's fever was.
- A patient died of a spinal infection when an anjio catheter needed for injection was not available.

[4] The incidents listed below are presented as exhibiting a correlation between the lack of medication and supplies and the subsequent deaths. The ONPA is not qualified nor was information available to evaluate the extent to which causal relationships may have existed.
[5] The ONPA could not verify the accuracy of these incidents.

The health assistants also reported that they have been unable to treat patients suffering from diabetes, leprosy, and tuberculosis. Similarly, conditions such as acute respiratory symptoms, diarrhea, pink eye, and the flu have gone untreated because of the unavailability of routine medications. Moreover, it should be noted that conditions such as high blood pressure and diabetes have consequences that are not immediately apparent. The consequences are long term and can result in premature death and disability.

Causes and Recommendations

Causes

The failure to ensure essential medications and supplies were available to island residents resulted from DHS's inadequate management practices in planning, inventory management, distribution and monitoring. Any organization must engage in these activities to plan which supplies (such as medications and medical supplies) will need to be purchased. An organization must also have an inventory management system so that its employees know which supplies are in stock, for use in planning deliveries, and for recording delivered items. Moreover, storage conditions must adequately protect inventory items and be organized so that staff can easily find needed items. Furthermore, management should monitor the performance of staff so that management knows whether key activities are being completed and whether objectives are being achieved.

DHS did not engage in any of these standard management practices. Shortcomings were noted in DHS's practices regarding the delivery, inventory management, and record keeping of items sent to the outer islands. For example, we found the following conditions:

1. **Absence of Procurement Planning**

DHS did not develop and implement a procurement plan to ensure essential medications are available where and when they are needed. According to DHS procurement officials, they have not developed a plan for the procurement of medicine and medical supplies. Instead, items are often purchased on an emergency basis.

The Chuuk State DHS "Dispensary Essential List of Medicines" should have been used as the foundation for the procurement of medicines and supplies. However, this did not seem to be the case. An analysis of the warehouse inventory list revealed that only 18 of the 33 essential medications (55%) were in stock at the warehouse. Thus, the failure to ensure the availability of essential medications on the outer islands cannot be attributed solely to challenges in making deliveries since most essential medications were not available at the DHS warehouse in Weno.

The DHS Director explained that their current Chief of Dispensary is on acting capacity only such that the job has not been receiving focused attention. He said that the recruitment of the Chief of Dispensary is in process.

2. Lack of Warehouse Inventory Management

DHS management failed to establish an inventory management system at the hospital warehouse that properly accounts for its inventory. Due to the absence of inventory record keeping, the warehouse had no accurate information on inventory levels. Stock room employees did not keep a running balance of the inventory of specific medications at the warehouse nor did they have a method for updating its inventory list when medications were transferred to the dispensary storeroom. A manual physical inventory report provided the only record of the quantity of each medication in the warehouse. However, the audit team found that the inventory report was not accurate and had not been updated since October 2006. As a result, the hospital warehouse is not aware of what essential medicines and supplies are available and can be transferred to the dispensary storeroom when requests are made by the dispensary storeroom.

3. Absence of Dispensary Storeroom Inventory Management System

The central Dispensary Division is not monitoring the inventory levels at its own dispensary storeroom or at the island dispensaries. The Dispensary Storeroom does not maintain an inventory listing nor does it require that the dispensaries submit periodic inventories. Therefore, the Dispensary Division does not have a mechanism to alert itself when it needs to request that the Division of Management and Administration's Storeroom Section initiate the procurement of medications. Instead, the Chief of Dispensaries relies on the island health assistants to radio him with requests for re-supplies. Additionally, the Chief of Dispensaries does not keep written records to document requests made to the Storeroom Division.

It should also be noted that the accuracy of existing delivery documentation is questionable. Some island health assistants reported that they did not verify that the quantity of delivered items was accurately recorded on the delivery record and two health assistants reported that they did not receive some of the items listed on the delivery document. Additionally, it was revealed that in one instance the wife of health assistant received the delivery and signed the delivery document on her husband's behalf.

4. Lack of Management Monitoring System

Dispensary management has not implemented a management monitoring system and therefore is unaware of how well its division is meeting the needs of the island dispensaries. The only records related to requests by the dispensaries and deliveries are scattered around the dispensary storeroom and are not filed in a manner that would allow information to be retrieved. As a result, dispensary management cannot match request and delivery documentation to ensure that requests are being fulfilled.

Moreover, when the audit team requested the records related to unserved requests of essential/urgent medicines and the correspondences of actions taken regarding those requests, the office was unable to provide a file. Division management has no clear knowledge

regarding the number of dispensaries not receiving their requests, the incurred number of days of delay in serving those requests, or the urgency/importance of the medications requested. Furthermore, without this knowledge division management can not effectively plan to identify and resolve these issues.

5. Absence of a System For Effective Distribution of Medicines to Dispensaries

There was no effective system to ensure timely delivery of essential medicines to the dispensaries. A distribution plan and budget that included delivery frequency, transportation costs (fuel) and timing was not in place.

The Dispensary Division did not maintain a complete record of its deliveries. Therefore, the audit team was not able to verify the extent to which medicines and supplies are being shipped to the outer islands. However, the 12 health assistants interviewed all revealed that they are not receiving their requested medicines in a timely manner. Eight (67%) of these 12 health assistants said that it was taking at least six months before they received their requested medicines. Furthermore, they mentioned that the Dispensary Storeroom is not sending the medicines that they requested.

As noted above, the Dispensary Division could not assure the audit team that it had complete records of its deliveries. Based on the records that were available, the audit team could only verify that 7 of the 83 island dispensaries received deliveries more than twice a year and that 25 dispensaries received a delivery only once in 2008. There were no records to indicate whether 44 of the 83 dispensaries (53%) received any medications in 2008.

Table 5 below presented the details of the audit analysis.

Table 5
2008 Frequency of Medicine Delivery to Dispensaries

Frequency of Delivery	Percentage of Dispensary
No Delivery	53% (44 of 83)
1 Delivery	30% (25 of 83)
2 Deliveries	10% (8 of 83)
3 Deliveries	4% (3 of 83)
4 Deliveries	2% (2 of 83)
5 Deliveries	1% (1 of 83)

Source – Audit analysis based on available documents

Recommendations

We recommend the following:

1. The Director of DHS should take action to ensure that dispensary management is aware of and competent to fulfill responsibilities related to the management of

dispensary inventory levels including the development and implementation of policies and procedures relating to:

a. The reordering of medicines and supplies
b. The timely delivery of medicines to the outer islands
c. The general record keeping and monitoring of inventories, dispensary requests for medicines and supplies, and deliveries

2. The Chief of Dispensaries be held accountable for ensuring that essential medicines are available when needed by Chuukese residents located on the outer islands.

3. The island dispensaries should be required to maintain inventory records and submit these records to the Dispensary Division on a monthly basis.

4. The DHS should actively take steps to recruit and hire Chief of Dispensary.

2. Expired Medicines were Included in The Inventory

Expired medications should be separated from unexpired medications to prevent the accidental use.

A large quantity of expired medications was found both at the Hospital Warehouse and the island dispensaries. The expired medicines both at the hospital warehouse and dispensaries were not physically segregated from the unexpired medicines. Fifteen percent (15%) of the medications at the warehouse (13,869 of 91,065 assorted bottles/boxes) were expired according to the January 2009 warehouse inventory report. Similarly, an audit inspection of six outer island dispensaries found that an average of 27 percent of the medicine inventory was expired.

Medications may remain effective for up to six months past the expiration date. However, many of the expired medications found at the hospital warehouse had exceeded the expiration dates by more than six months. The following table contains examples of expired medications found by the audit team during an inspection of the hospital warehouse conducted on March 14, 2009.

Table 6
Examples of Expired Medicines at Hospital Warehouse

Medicine	Description	Dose	Expired	Quantity
Vitamin K Injection	Injection for Bleeding	10mg/ml	Apr-07	660
Fentanyl Injection	Operating Room pre-medicines	100micro/gr	Aug-08	680
Valium Injection	Tranquilizer	10mg/2ml	Oct-08	560
Salbutamol Syrup	Anti-Asthma	60ml/bot	Jan 09	739

Source Physical count at the Hospital Warehouse

Causes and Recommendations

Causes

As discussed in Finding 1, we found that DHS had not implemented inventory management practices. Comingling of expired and current medications can be attributed to the lack of policies, procedures**,** and practices governing the inventory management function. For example, we found:

- Though the expiration dates are recorded on the inventory list, staff do not periodically review the list to identify expired medications and then remove those medications.

- Medications are placed on the shelves in a haphazard manner. There is no system to ensure that the older stock of a specific medication is used before the newer stock of the

same medication is used. For example, a grocery store that receives a new shipment of milk will put that milk behind the existing milk containers (which will expire sooner) so that the customers take the milk that will expire sooner rather than the milk that will expire later. The warehouse did not engage in a similar practice.

- Management has not developed a system to monitor the use of medications. According to personnel, inventory reports are not utilized as basis of decisions. Without a monitoring and reporting system, management is more or less guessing "when" and "how much" medication to re-order. As a result, it ends up with large quantity of unneeded medications that eventually expire.

When lax inventory management practices resulting in large quantities of expired medications occurs, two consequences result. First, the presence of expired medications presents a risk. The medications may be given to a patient but since they are expired, the medications have lost their power and will not have the desired effect. In other words, treating a patient with expired medications is the same as not treating a patient.

Second, the large quantity of expired medications suggests that funds are being wasted. A health organization must be prepared for emergencies and large outbreaks of common diseases and, as a result, it must have sufficient inventory on hand. It is expected that a portion of the inventory will expire. However, if a large portion of purchased medications expires, it suggests that poor planning is resulting in the waste of government funds.

Recommendations

DHS should develop and implement policies and procedures to ensure that expired medications are promptly identified and removed from the inventory. Specifically, policies should dictate that on routine basis, staff should review the inventory report to identify expired medications and that those medications then be removed from the inventory.

3. Medicines Purchased From Immediate Family Members of DHS Officials and Staff

DHS employees, officers, and agents are prohibited from participating in the selection of vendors and administration of contracts if a real or apparent conflict of interest exists.

The Compact Fiscal Procedures Agreement (FPA) states:

> *A written code of conduct shall be maintained by the Government of the Federated States of Micronesia to govern the performance of its employees engaged in the award and administration of contracts. No employee, officer, or agent of the Government of the Federated States of Micronesia shall participate in the selection, award, or administration of a Contract supported by funds provided pursuant to the Compact, as amended, if a conflict of interest , real or apparent, is involved.*[6]

Chuuk State Financial Management Regulations also address the concern of potential conflicts of interest. Section 6.42 requires that:

> "*Any officer or employee of the state that has an interest in any firm, company and corporation interested in the procurement with the state shall disclose such interest in writing to those reviewing the contract on behalf of the state. It further states that "he shall not participate in any committee, board, or staff in reviewing and decoding the said contract..."*

We found the following:

1. Purchases With Appearance of Conflict of Interest

$2,035,402 worth of medications and supplies/equipment were purchased in instances where it appeared that a conflict of interest existed. The audit team found several instances when medications and supplies were purchased from companies owned (in whole or part) by DHS staff and officials or their family members.

In the following instances, DHS and DAS representatives involved in the purchasing decision appeared to have conflicts of interest. They were involved in the purchase of medications from businesses in which family members had a key interest. We found that during the three-year period reviewed by the auditors, the following occurred:

- $1,317,731 was paid to a **Business Establishment A.** The nephew of a DHS employee involved in making purchasing decisions is a key employee of Business Establishment A. The key employee of Business Establishment A is also the brother of a Chuuk government official who at times serves as the designated approver of purchase requisitions.

[6] Article VI (j) (3) of the Compact Fiscal Procedures Agreement

- $368,5684 was paid to B**usiness Establishment B.** The business owner's husband is a nephew of a DHS employee involved in making purchasing decisions. This is the same DHS employee discussed in case 1. Furthermore, the business owner is the sister-in-law of a DAS official who at times is the designated approver of all transactions processed by DAS including purchase requisitions.
- $109,628 was paid to **Business Establishment C** whose owner is a consultant (now resigned) of Chuuk State DAS. These purchases were made at the time the employee was still working with DAS. The financial consultant was not directly involved in the selection and administration of procurement but the transactions gave an apparent conflict of interest since the consultant could influence prioritization of payments.
- $38,550 was paid to **Business Establishment D** whose owner is an official of a department responsible for approving transactions including purchase requisitions.

We also found one instance in which a potential conflict should have been reported, as required by Chuuk Regulations.

- $200,909 was paid to **Business Establishment E** whose owner is the daughter-in-law of a Chuuk State Hospital doctor. Because the role of a doctor at the hospital involves formally or informally requesting the purchase of medications/supplies, this potential conflict should have been reported.

This condition compromised the interest of the state for personal interest, and gave the perception of preferential treatment in awarding purchase orders. In addition, this practice diminishes the public's trust that the government is operating in the best interest of the public. Limitations resulting from DHS's record keeping system prevented the audit team from determining if items discussed above could have been purchased at a lower cost.

Upon request, the DHS Director was provided with identification of these business establishments with an appearance of conflict of interests.

2. No Written Code of Conduct To Govern The Behavior of Employees

We noted that the Chuuk State has not established a formal code or codes of conduct communicating appropriate ethical and moral behavior standards and addressing acceptable operational practices and conflicts of interest. Thus, employees are not reminded of what kind of behavior is acceptable and unacceptable, what penalties unacceptable behavior may bring, and what to do if they become aware of unacceptable behavior.

As a result, issues such as conflicts of interest, acceptance of gifts or donations, improper payments, and inappropriate use of resources are not directly addressed.

Cause and Recommendations

Cause

DHS did not establish or implement policies and procedures to ensure effective compliance with the regulations on conflict of interest.

Recommendations

We recommend Chuuk State CFCC, DAS and DHS should:

- Develop the necessary control procedures to enforce the conflict of interest provision of the regulations and to ensure the integrity of the procurement processes from solicitation to evaluation and selection of the winning bid/quote for the procurement that would involve conflict of interest.
- Develop and implement policies and procedures that would also require supplier/vendor/contractor to identify employees to whom they are related.

We recommend Chuuk State Personnel should:

- Develop and implement a code of conduct to set the standards for ethical and moral behavior of all the state employees.

4. Approximately $700,000 Worth Of Purchased Medications Not Received

Basic business practices require that if an organization pre-pays for goods or services, it should ensure that it receives the goods or services.

Additionally, the Compact Fiscal Procedure Agreement requires that the individuals responsible for procurement consider the potential contractor's integrity, compliance with public policy, record of past performance, and financial and technical resources[7]. The agreement further states that awards shall be made only to contractors/vendors who possesses the ability to perform responsibly and successfully under the terms and conditions of a proposed procurement

In 2006, Chuuk DHS implemented the practice of making prepayments to offshore vendors of medications and supplies. However, the DHS never implemented policies, procedures, or practices to ensure that goods were received.

Chuuk DHS made pre-payments totaling $699,297 to offshore vendors and there is no indication that the goods were ever received. DHS practice has been to make an advance payment of 75% of the purchase order amount for all off shore purchases of medicine and medical supplies. The remaining 25% is to be paid upon receipt of the items.

We reviewed payments to five vendors who were paid in advance and found there was no evidence to document that the goods were received. DHS did not have receiving reports or other documents to indicate that they ever received the shipments. Likewise, the DAS provided the audit team with a certification stating that they have not received the items. Moreover, a review of accounting records revealed that DHS never paid the final 25% due upon receipt, which further indicates that the goods were not received.

When asked to explain, DHS and DAS officials expressed that they were not aware that some vendors have not delivered items which DHS has paid for. Moreover, the officials stated that they were not monitoring the status of pre-paid items. According to DAS officials, the hospital supply supervisor and storeroom supervisor should have been monitoring procurement events but these staff were not.

Table 7 on the following page provides summary data of prepayments made by DHS for which there is no evidence that the goods were ever received.

[7] Article V1, Section 1.j. of Compact Fiscal Procedures Agreement

Table 7
Prepayments Made With No Evidence of Receipt of Goods

Vendor	Number of Purchase Orders	Date(s) Paid	Amount of Advances Paid
Vendor A	11	Jan – June 2006	295,755
Vendor B	4	Jan, July, and Nov 2006	194,562
Vendor C	7	Jan – Sept 2006	150,789
Vendor D			53,126
Vendor E			5,064
Total			699,296

Source: ONPA Analysis of DHS Expenditure Report

We sent emails to suppliers to confirm the undelivered purchases with them. As of the date of this report, we did not receive any reply from the suppliers.

After the audit team brought this issue to the attention of DHS Officials, the Department received a partial shipment of goods for which it had paid for in 2006. DHS had paid Vendor A approximately $295,000 in January to June 2006. In April of 2009 or about three years after PO dates, the vendor shipped partial shipment worth $6,084 of medication to DHS during the course of the audit.

As a result, the amount of $699,297 was wasted. The amount was expended and Chuuk received no benefit from the expenditure.

Causes and Recommendations

Causes

The audit team found that DHS had not implemented policies or procedures to conduct background checks of potential vendors. The current DHS Procurement Officer stated that new vendors get referred to him and he does not do any background checks. For example, a dentist at the dental clinic referred one supplier and a DAS financial consultant referred another. Additionally, many vendors had already been doing business with DHS when the Procurement Officer assumed his position.

Additionally, the DHS also failed to monitor its pre-payments and conduct follow-up activities to ensure it received the goods.

Recommendations

We recommend that the:

Chuuk DAS/DHS should account for all advance payments to off shore suppliers and should recover any accounted advances to suppliers.

Chuuk DAS/DHS should implement policies and procedures to ensure accreditation process including background checks are completed for potential vendors. This process should include verifying that potential vendors are registered businesses capable of supplying specific products and services.

Chuuk DAS/DHS/CFCC should develop and implement control procedures for the processing and liquidating of advance payments to off shore suppliers. These control procedures should include temporary treatment of advance payments as receivable account in the books subject to subsequent monitoring of delivery of goods paid in advance and reversal upon liquidation.

After this issue was brought to the attention of the auditees, the CFCC, the DAS Director, and the Chuuk Attorney General agreed to a new policy regarding advance payments. The policy effective October 1, 2009 contains the following features:

1. The practice of advancing 75% of purchase order amounts for all off-island purchases was discontinued.

2. The new policy is that cash advances are generally not made to off-island vendors and services providers. However, the policy is flexible and can allow advances as follows:

    - Advances to vendors up to 100% of the contract or purchase order price depending on the particular circumstances.

    - Advances to service providers limited to 20% of the contract price.

    - Mobilization payments for construction projects limited to 10% of the contract price.

    - Advances specifically authorized in writing by the Office of Insular Affairs.

3. The requirements for an advance include:
    - A written request from the vendor or service provider.
    - A written agreement either in the contract or a separate agreement defining delivery dates, terms and penalties for non-delivery and signed by all required parties.
    - Approval of the advance and amount thereof by both DAS and CFCC.

4. Advances will not be made to local vendors with the exception of 10% mobilization advances for construction projects. Requirements for these advances are the same as for off-island advances.

5. Unsound Procurement Practices Likely Circumvented Competitive Procurement Requirement

Procurement transactions should be conducted in accordance with CFMR and FPA requirements. These requirements, which were established to safeguard the financial assets of Chuuk State, specify the process by which good/services should be procured and dictate what procurement-related documents should be retained.

In reviewing 54 payment vouchers, the audit team found various instances of non-compliance with procurement requirements. These included the following types of infractions:

- False or Questionable Quotation
- Purchase Orders Not Subjected to Bidding
- Splitting of Purchases to Avoid Bidding Requirements
- Purchase Orders Not Supported by the Required Minimum Three Quotations
- Justification For Selection of Supplier Not Documented
- Emergency Purchases Not Supported by Approved Emergency Declaration
- Purchases Not Adequately Approved/Supported

1. Purchase Order Supported by False or Questionable Quotation

We found several cases wherein purchase orders were supported by either false or questionable quotations. For purchases of less than $100,000 a department is allowed to obtain quotations rather than the more formal bids. In several instances the audit team noted questionable quotations. Specifically:

- We noted one instance in which quotations appeared to have been falsified. The dates of the quotations provided by the two vendors which were not selected appeared to have been falsified by DHS. The formats were different from the other quotations that the suppliers have been preparing and submitting to DHS. Specifically, the quotations did not provide information on quantities but only showed items, sizes and unit prices when the supplier's traditional quotations showed items, quantities, size, unit prices and amounts. Additionally, the dates were manually erased and altered. When questioned by the audit team, both vendors denied making the changes. Additionally, in this instance the purchase exceeded the threshold for quotations meaning that the more formalized bidding process should have been followed. Moreover, the selection of the winning supplier appeared to violate conflict of interest regulations, as discussed earlier in Finding 3 (B**usiness Establishment B)**. These questionable quotations were attached in support of a PO (#L13679 dated 6/11/08) amounting to $255,389[8].

[8] The receipt of these items were not documented by a receiving report as required under section 6.9 of CFMR

- We also noted two cases of POs with fictitious quotations attached. The quotations were obtained from a store that was neither selling nor distributing medicines. When asked to explain, the purchasing officer admitted that the quotations were attached to satisfy the requirement that a minimum of three quotations be obtained. The total of these POs was $109,876.

Table 8
Purchase Orders with Fictitious Quotations

PO#	Date	Amount	ONPA Comments
P60031	3/12/2006	71,573	With undelivered Prepaid Purchases under Finding No. 4-Vendor A
P60051	3/31/2006	38,303	With undelivered Prepaid Purchases under Finding No. 4-Vendor A
Total		109,876	

Source – DAS vouchers

- Eleven (11) of 54 payable vouchers (20%) reviewed by the audit team were supported by quotations which appeared to have been received after the purchase requisitions had already been approved. The standard chronological order of events is that quotations are obtained before the purchase requisition is prepared. These orders totaled $119,131.

Table 9
Examples of POs with Questionable Quotations

PO#	Amount	PR Date	Quote 1 Date	Quote 2 Date	Quote 3 Date
P80171	62,610	11/30/07	11/22/07	12/4/07	No date
P60047	31,778	3/20/06	4/3/06	3/27/06	No date
P60088	11,616	5/19/06	6/24/06	No date	No date
P60093	12,305	6/2/06	3/14/06	6/27/06	No date
P60046	52,501	3/20/06	3/14/06	No date	No date

Source – DAS vouchers

2. Purchase Order Not Subjected to Bidding

FPA requires purchases greater than $100,000 to be procured through a competitive sealed bid. Those below $100,000 may be procured through quotations from an adequate number of suppliers.

In three instances purchases were made without following the process for purchases over $100,000, which requires the solicitation of sealed bids. We found:

- A PO # P70054 dated 5/4/07 amounting to $114,915.38 for purchases of medical supplies. This PO was instead subjected to solicitation by quotation, which is allowed only for purchases below $100,000.

- Two POs totaling to $200,000[9], representing the seed money to be deposited in a trust account for the operation of the TPA for off-island patient referral system. Both the DHS Procurement Officer and the DAS Chief of Planning claimed that these two POs were awarded through sealed bidding. However, we noted inconsistencies in the documents that were attached to the voucher for payment of TPA deposit.

  First, we noted the PO # 70056 amounting to $192,107 was not the appropriate attachment for APV #7003803 amounting to $50,000 because of the amount in the PO was unsupported by any documents.

  Second, the attached proposals to the vouchers were questionable due to the following observations:
  - Supplier A, the winning supplier, did not indicate any proposed rate (amount of service) in its proposal.
  - Supplier B's proposal was dated January 17, 2007, which was after the December 2006 effective date of the TPA agreement. This indicated that Supplier B's proposal was not yet received at the time the winning supplier was decided.
  - Supplier C's proposal has no date. Furthermore, it did not satisfy the required specification as to preferred place of accommodations. Thus, this proposal should have been rejected necessitating the need to obtain another proposal to satisfy the required minimum number of three bids before evaluation of bids could proceed.

Due to above deficiencies, we doubted that the awarding of the POs were competitively obtained.

Refer further to the explanation of CFCC under item 6 on page 25 of this report.

3. Split Purchases Avoided the Bidding Threshold Amount

CFMR prohibits splitting of purchases to avoid bidding. Specifically, CFMR 6.13 states that, "…Purchases shall not be segregated into smaller lots to avoid the bidding process…"

However, we found cases of purchases divided into smaller lots during the 12-month period. Specifically,

- Four POs amounting to $212,517 were awarded within a month to the same supplier. Three of these four POs shared the same date. The items covered by these POs were also undelivered as pointed out under Finding No. 4. Refer to Vendor A under Table 7.
- Three POs amounting to $128,447 were awarded to another supplier. These three POs all shared the same date. This supplier has also related finding regarding conflict of interest under Finding No. 3 **(Business Establishment A**).

4. Purchase Orders Not Supported by Required Minimum Three Quotations

[9] Two POs for the same services –(1) PO70056 dated 5/08/07 for $192,107 in which the amount paid was only $50,000 and (2) PO14339 dated 7/17/08 for $150,000

CFMR requires purchase orders to be supported by minimum of three price quotations. Specifically, CFMR 6.5 states that "in determining the applicability of and compliance with open competitive bidding, the Director or his designee may accept no less than three price quotations from the purchasing government agencies…"

Of the 54 payable vouchers and purchase orders tested, we found that 22 (41%) vouchers were not supported by the required three quotations. Most of these cases had only one quotation as an attachment. The total of these payable vouchers was $110,732.

5. Justification For Selection of Supplier Not Documented

CFPA requires this selection of suppliers to be documented. Specifically, CFPA Article VI (j)(5) states that, "records shall be maintained with sufficient detail to document the history of a procurement including but not limited to the rationale for and method of procurement, the selection of contract type, contractor selection or rejection, and the basis for the contract price."

The rationale for the selection of the supplier in 29 sampled (54 percent) payable vouchers was not documented. Without documented justification, the selection decision cannot overcome the appearance of subjectivity. The total of these payable vouchers was $538,152.

6. Emergency Purchases Not Supported by Approved Emergency Declarations

CFMR requires emergency purchases to be supported by approved emergency declarations. Specifically, CFMR section 6.12 (f) states "… when there exist a threat to public health, safety or welfare under conditions of an emergency as declared by the Governor in writing…"

None of the four emergency purchases tested had the required emergency purchase declarations in the file. The total of these emergency purchases was $10,996.

According to CFCC, the Chuuk State Attorney General issued an opinion on October 16, 2007 stating that "…*in our opinion, purchases funded by Compact fund/sector grant should comply with the Fiscal Procedures Agreement*".

The CFCC further said that the Grant Manager, Compact Health Sector issued instructions to CFCC on October 16, 2006 concerning exceptions to regular procurement procedures in the case of medical exigency and emergencies. The instructions stated that the "examples of situations that call for procurement outside the norm include the need to rapidly respond to communicable disease outbreaks and provide immediate medical care during or immediately after natural or man-made disasters. Other circumstances include: (1) emergency purchases in cases where there is an absolute shortage or imminent outage of essential pharmaceuticals and medical supplies despite "good faith" efforts to maintain adequate inventories; (2)

emergency repair or immediate replacement of medical equipment deemed critical to clinical diagnosis and treatment; (3) emergency fuel purchases for in-state medical evacuations; (4) the procurement of drugs that are not part of the regular hospital formulary but that are medically indicated for specialized treatment".

Furthermore, the CFCC said that because of the Attorney General's opinion and instructions from the Health Sector Grant Manager, CFCC approves purchases based on FPA rules and the instructions of the Compact Health Sector Grant Manager concerning emergency purchases of medicine and medical supplies. CFMR section 6.12 (f) grants exemption from open competitive bidding by sealed bids in emergencies declared by the Governor.

Lastly, the CFCC said that they are not aware of approving non-competitive emergency purchases that would require sealed bidding by the FPA.

7. Purchases Not Adequately Approved/Supported

CFMR section 2.4 states "... the Director of DAS shall be the accountant for all funds of the Chuuk Sate Treasury. The Director or his designee shall record and certify every receipt and disbursement of all monies paid to, by, or through the Chuuk Sate Treasury…"

CFMR 6.9 states in part, "…Government funds shall not be disbursed to pay an obligation under Purchase Order unless a receiving report confirming the receipt of goods or services is transmitted to the Director by the Head of the acquiring agency.

The Director of DAS's approval of vouchers before funds could be expended to safeguard DHS funds from loss, fraudulent, or improper use.

Of the 54 sampled payable vouchers and purchase orders tested, we found:

- Two cases of payable vouchers without approved purchase requisitions (PR). The total of these unapproved purchase requisitions was $30,275.

- Nineteen vouchers (35 percent) were not supported by receiving reports. The total of these purchases was $344,205.

- Four vouchers were not approved. The total of these unapproved payments was $89,324.

The conditions described above suggest that DHS may have acquired goods/services at a higher than needed rate resulting in the waste of government funds. Moreover, the failure to comply with required procurement regulations that intend to ensure fair and equal competition among vendors can have the effect of eroding the public's confidence that the government is acting as a good steward and in the best interests of the public.

Causes and Recommendations

Causes

1. There was inadequate review of documents and transactions to ensure that payments of goods and services were adequate and properly supported.
2. There was no selection procedure governing procurement.
3. There was lack of internal control procedures in ensuring that the provisions of FPA are strictly observed.
4. There was no procurement plan ensuring that all the needs for medicines were competitively procured.

Recommendations

1. The CFCC, DAS and DHS office should be more diligent in its documentation to secure PO. Adequate support, and explicit override approval with justification should be attached to the voucher when any procurement is done outside of the requirements of the regulations or FPA agreements. Without such documentation, the offices cannot support that it has been following its own policy to obtain competitive pricing.

2. DAS should develop and implement the selection procedures for awarding of PO to the supplier.

6. Absence of Accountability and Poor Inventory Management Led to Various Inefficiencies

Standard inventory management practices are expected of every organization involved in the procurement and distribution of goods. These practices include:

- Maintaining accountability over inventory[10]
- Standardized procedures for organizing, securing, and maintaining items stocked in the warehouse
- Maintaining an accurate perpetual inventory record
- Documenting the movement of inventory items into and out from the warehouse

The audit team inspected the warehouse on March 14, 2009 and found the following conditions:

1. Discrepancies Between Physical Count and Inventory Record

We performed test-counts of medicines and supplies at the warehouse. The inventory report did not correctly indicate the inventory on hand. The result of our test-count indicated that discrepancies existed in 94 percent (60 of 64) of the items test-counted.

Table 10
Examples of Discrepancies between Count and Inventory Report

Description		Strength	Per Record	Per Count	Difference
o Morphine Injection	10mg/ml	1ml/Amp	250	-	(250)
o Bisacodyl	5mg	100/bot	640	1,006	366
o Phytomenadione	2mg/0.2ml	50amp/bx	100	630	530

Source: ONPA inventory count and analysis of inventory records

2. Incomplete Inventory Listings

The January 2009 Quarterly Stock Inventory report did not include all inventory items in stock. Specifically, donated medicines were not included in the listing.[11] This showed that the warehouse personnel may omit some details of inventory items and the reviewer would not notice any omission.

[10] Inventory accountability is defined as the state of being liable or responsible for the accuracy of inventory balances.

[11] When this problem was brought to the attention of the concerned person; the inventories of the donated medicines appear in the monthly stock inventory report starting June 2009

3. Inefficient Storage Conditions

During the stock count at the DHS central warehouse, we observed that the warehouse was not properly maintained. We observed that medicines were not systematically stored. They were not properly arranged on the shelves. The bin cards and labels were not being used (see Image 1). Medications and supplies were still kept in their original boxes and were not stacked properly. We also observed that the housekeeping was disorderly. For example:

- We spotted a bed with pillow inside the warehouse that appeared to be being used (see **Image 2**). According to the Medical Supply Officer, the bed and the pillow belong to him and were intended to be taken home but he was not able to do it.
- We likewise noted that smoking appears to be allowed inside the warehouse. We found an empty can of soda with trace of cigarette ashes on top of a box containing an inventory of gauze bandages (see **Image 3**). This smoking habit inside the prohibited area is a fire hazard and unnecessarily exposed the medicines inventory to the risk of loss due to fire.
- We found evidence of rats inside the warehouse. There were rat droppings and shredded particles caused by rats (see **Image 4**). This exposed the medicines to potential damage by rats.
- Lastly, we found trash that was thrown inside a box containing medicines. The trash included a styrofoam glass, an empty ice tea can and an empty plastic bottle of 7-up (refer to **Images 5 and 6**). This exposed the medicines to the risks of contamination.

Image 1 Photograph of disorderly stack of medicines. Bin cards and labels are not maintained. At the corner is a bed with pillow. This photo was taken by the auditor at the DHS central warehouse.

Image 2 Close-up view of a bed and a pillow that seemed being used. According to the person in-charge of the warehouse, the bed and the pillow belong to him and would take them home. This photo was taken at the DHS central warehouse.

Image 3 Photograph of an empty soda can being used as ashtray. The ashes are scattered on top of a box containing gauze bandages. This strongly suggest that cigarette smoking is allowed inside the Warehouse, thus, unnecessarily exposed the medicines inventory to risk of loss due to fire. This photo was taken by the auditor at the DHS central warehouse.

Image 4 Photograph of rat's droppings and shredded particles caused by rats. This strongly suggest that rats that could damage medicines are inside the warehouse. This photo was taken by the auditor at the DHS central warehouse.

Image 5- Photograph of boxes containing good medicines that was also used as trash boxes. This photo was taken by the auditor at the DHS central warehouse.

Image 6 - Close-up view of the trashes inside a medicine box. These trashes include used styrofoam glass, empty ice tea can, and empty 7-up plastic bottle among others. The trashes are fire hazard and thus, exposed medicines to risk of loss due to fire. This photo was taken by the auditor at the DHS central warehouse.

As a result of inappropriate management of inventory, stocks in the warehouse could be damaged, lost or stolen but such occurrences may not be detected.

Causes and Recommendations

Causes

The problems discussed above were mainly due to inadequate warehouse management practices including the absence of policies and procedures for storage and handling. Specifically:

1. There were no standard operating procedures for warehouse operation to safeguard inventory and promote good housekeeping and efficient utilization of storage space.

2. There were no inventory control policies and procedures to provide stock accountability. For example, there was no policy requiring that the organization maintain complete and updated warehouse inventory records

3. Inventory reports were not submitted timely. The inventory reports were submitted on a quarterly rather than monthly basis. As such the report was never used for tracking and decision purposes e.g.; decision to purchase medicines. Note: Starting June 30, 2009 reporting, the person in charge of the warehouse began submitting a monthly inventory report.

4. Warehouse personnel have insufficient knowledge of the internal controls required to manage an efficient warehouse operation, to record and maintain accurate perpetual inventory records, and to properly store and account inventory items.

5. There was no periodic count of inventory and comparison against perpetual inventory records.

6. There was an absence of reliable inventory records. The warehouse lacked perpetual inventory records.[12] In lieu of perpetual inventory records, the person in charge of the warehouse had been counting and reporting a manual inventory report. The audit team attempted to verify the accuracy of the report but found the inventory report to be unreliable due to the following conditions:

    - The movement of inventory items into (receipt) and out (issues) of the warehouse was not fully documented.

      Although the receipt of inventory items was documented by the use of a receiving report, this document was not directly used as the basis for entries in the inventory report. Furthermore, the warehouse is not keeping a file copy of the receiving report.

[12] Perpetual inventory record is a method of stock control in which a daily record is maintained of both the dollar amount and the physical quantity of inventory, and this be reconciled to actual physical count at short intervals.

On the other hand, medicines that were taken out (issues) of the warehouse were not properly documented. According to the person in charge of the warehouse, it has not been a practice to formally document the request of medicines and supplies for release (from the warehouse). Furthermore, he said that medicines were requested orally or sometimes a physician would just come into the warehouse and take needed medicines without documenting them.

Recommendations

We recommend that the DHS and DAS improve the warehouse inventory management by implementing inventory and warehousing policies and procedures that would include but not be limited to the following:

DHS

1. Guidance on proper warehouse housekeeping, organizing, securing and storing of inventories. These guidelines would ensure orderliness, safety and efficient retrieval of items inside the warehouse.

2. Warehouse access and security; inventory record keeping; receipting; storing; issuing; periodic counting; and reducing loss and wastage through expiry, theft, damage, and others.

3. Safe disposal of unwanted/expired medicines. Among others, such policies and procedures should address the need to physically segregate expired medicines from good medicines and requiring prior approval before expired/unwanted medicines are disposed of.

4. Training sessions to strengthen the capacity of the staff on warehouse inventory control and management.

DAS

5. Forms for receipts and issuances be properly authorized and used for posting to the perpetual inventory records to assure correctness and properly establish custodian's accountability
6. Pre-numbering of receiving report and issuances forms should be implemented to enable accounting of the completeness of inventory transactions. This would ensure that movements of goods is recorded and records are accounted for
7. Physical inventory at least once a year and compare the results of the physical count with perpetual inventory records to establish responsibility for any missing items in the inventory.

7. Lack of Control Over Fuel Purchases Resulted in 70% Increase in Fuel Spending During Two Year Period

The FPA requires maintenance of sufficient records. Specifically, the FPA5 states that:

> *"...records shall be maintained with sufficient detail to document history of procurement…."*

In the same manner, the Chuuk State FMR requires proper approval and documentations before payment could be processed. Specifically, the FMR 6.9 states that:

> "*…government funds shall not be disbursed to pay an obligation under Purchase Order unless an original copy of the invoice is received by the Director or designee and a receiving report confirming receipts of goods or services is submitted to the Director by the Head of the acquiring agency….*"

During the period covered by the audit from fiscal year 2006 to 2008, the DHS incurred a total of $914,804 in fuel purchases (gasoline, diesel and gas). $828,200 (91%) of the fuel purchase was incurred by the Hospital and Management Division. The fuel purchases were primarily intended for fuel consumption of the hospital's generators. Table 11 below provides detailed information regarding the expense incurred by each of the divisions during the three years. The table also shows that the Hospital and Management Division incurred a 75% increase from FY 2007 to FY 2008, from $242,510 to $423,398.

Table 11
DHS Petroleum Oil and Lubricant (POL) Expenditures for Fiscal Years 2006-2008

DHS Division	FY 2006	FY 2007	FY 2008	Total	Percentage Increase From Prior Year	
					2007	2008
Hospital and Management	162,292	242,510	423,398	828,200	49%	75%
Public Health		498	1,182	1,680	0%	137%
Dispensary	4,998	24,994	30,752	60,744	400%	23%
Sanitation	1,522	5,251	3,750	10,523	245%	(29%)
Dental	784	2,999	1,475	5,258	283%	(51%)
Nursing			5,400	5,400	0%	0%
Red Cross			3,000	3,000	0%	0%
Total	169,596	276,252	468,956	914,804	63%	70%

Source – Trial Balance from Chuuk State DAS, unaudited

The results of audit testing revealed that records and documents did not adequately establish the appropriateness and justifiability of fuel payments. Specifically, the DAS did not attach (to the vouchers) the required receiving reports and suppliers' invoices evidencing that bulk fuel purchases were actually received and payments matched with the receiving reports and suppliers' invoices. Moreover, DHS did not properly safeguard and account for fuel purchases that were initially stored as inventory and later used by DHS or withdrawn by other departments.

The results of audit examination were as follows:

1. Bulk Fuel Purchases Were Unaccounted For

The usage of fuel purchases was unaccounted for. DHS has no records in file showing the quantities of fuel used in the hospital's generators or quantities issued to other departments. For example, it cannot be demonstrated how the June 16, 2008 payment for 3,180 gallons (60 drums) of diesel worth about $19,000 was received and consumed. In another example, the July 2, 2008 payment for 1,590 gallons (30 drums) of diesel worth about $11,000 cannot be accounted for. All of bulk fuel purchases presented in Table 11 were unaccounted for.

2. DHS Provided/Paid the Fuel Needs of Other Departments/Agencies

Fuel purchased by DHS was given to other Chuuk State departments and agencies. These fuel needs were not specifically approved under the DHS budget. Though the quantities and amounts cannot be established from the records, it was reported that other departments were getting their fuel requirements from the fuel storage at the hospital area or the DHS paid the fuel purchases of other departments or agencies. In a report[13] to the OIA in Honolulu, it was indicated that the DHS Director and his staff admitted that the DHS has been supplying diesel fuel to other offices and agencies of the Chuuk State Government with an understanding the said agencies/departments would pay back the fuel. Such departments and offices were as follows:

- Governor's Office
- Department of Public Safety
- V6AK Radio Station under the Public Affairs Division of DAS
- Office of the Department of Transportation (operating the ship MV Chief Mailo)
- Public Works Division under Department of Transportation
- Chuuk State Airport Division under Department of Transportation
- Chuuk State Supreme Court
- Supply & Procurement Section under DAS

[13] Report dated August 8, 2008 issued by an OIA Consultant, working with CFCC, to the U.S. Office of the Insular Affair at Hawaii.

The officials of the departments and offices that obtained fuel from DHS confirmed receiving fuel from DHS, citing reasons such as not having the funds available to purchase fuel. The results of interviews with officials of these departments and offices indicated they did not intent to return the fuel or reimburse DHS.

The ability of DHS to provide the fuel needs of other departments or agencies may be indicative of faulty budgeting. It appeared that the DHS's budget for fuel (POL) was significantly over budgeted. As a result, DHS was able to provide even for the fuel needs of other departments and agencies. Thus, the DHS unnecessary increased its fuel purchases, which have also remained unaccounted due to absence of receipts and invoices supporting payments and the absence of records that would allow full accounting of fuel inventory receipts and withdrawals.

3. Inadequate Supporting Documents / Approval of Fuel Payments

We also found that the DHS/DAS did not attach the supplier's invoice and receipts evidencing receipts of fuel. Of 27 selected vouchers, 22 representing 83 percent (22 of 27) of the vouchers have no attached suppliers' invoices or DAS receiving reports. The total amount of these vouchers was $316,573. Refer to Table 13 for examples of fuel purchases without supporting supplier's invoice and receipt. These 22 vouchers further included two vouchers amounting to $75,763 for MV Chief Mailo's trips to outer islands. These trips were opened to all and MV Chief Milo collected fees to passengers and baggies, however, the whole cost of fuel was charged to DHS.

Table 13
Examples of Fuel Deliveries without Attached Receiving Report and Supplier's Invoice

Date Paid	Description Per Voucher	Number of Galloons			MPR Amount	Additional ONPA Comments
		Gasoline	Diesel	Kerosene.		
5/8/08	Fuel for hospital's generator		1,060		5,384	
5/8/08	Fuel for hospital's generator and kitchen		1,060	53	5,651	
5/8/08	Fuel for MV Chief Mailo for field trip services to Namonwitto and northwest region (May 16 to 21)	318	9,201		47,460	Not budgeted under Hospital and Management
5/13/08	Fuel for hospital's generator		1,060	106	5,918	
5/13/08	Fuel for hospital's generator		1,060	106	5,384	
5/28/08	Fuel for hospital's generator and kitchen		1,060	106	5,918	Voucher not approved by the allotee

Date	Description Per Voucher	Number of Galloons			MPR	Additional
5/28/08	For Hospital Daily Operation				4,802	Gasoline not budgeted under Hospital and Management
6/30/08	Hospital Standby Generator		3,180		19,069	
07/18/08	Hospital Standby Generator				10,354	
7/23/08	Fuel for MV Chief Mailo for field trip to Mid & Lower Mortlock islands for services from Education and Health Services and other offices.		4,671		29,998	Not budgeted under Hospital and Management
7/25/08	Fuel for hospital's generator		1,590	106	10,969	
7/29/08	Fuel for hospital's generator and kitchen	1,000			16,892	Gasoline not budgeted under Hospital and Management. Use of gasoline unaccounted.
7/31/08	Fuel for hospital's generator and kitchen	1,000			16,802	Gasoline not budgeted under Hospital and Management. Use of gasoline unaccounted
8/20/08	Hospital Standby Generator				10,354	
Total					194,955	

Source –ONPA review of DAS Vouchers

As a result, the check drawn for each PO was not fully accounted for and justified.

Causes and Recommendations

Causes

The DHS and DAS did not implement internal controls to ensure the economical use and proper accounting of funds for fuel purchases:

1. DAS Did Not Require Bulk Fuel Deliveries be Supported by Receiving Report

Although required by the regulations, the DAS did not prepare receiving report for every receipt of fuel delivered in bulk (in drums) by the gas company to the DHS site. The DAS Officer explained to the audit team that the DHS staff was the one actually receiving fuel deliveries. The DAS Officer further stated that the DAS did not have the time to accompany the DHS personnel during the process of receiving the fuel upon delivery.

According to the DHS Supervisor, the supplier's documents such as the invoice and delivery receipt were given to the Secretary of DHS Administration for forwarding to DAS but it was

not done. The DAS did not enforce that said documents be submitted as required by the regulations.

2. No Accurate Record of Fuel Utilization of DHS Generator

The entries in the generator operation log were not complete. The DHS did not maintain an accurate record of the generators' utilization containing information such as turn on/off time and fuel loading. According to the concerned personnel, an operation's log is maintained but the entries therein were not complete since the staff did not consistently log all of the activities requiring logging.

Thus, it cannot be accounted how much of the DHS fuel purchases were actually used by DHS to operate their generators.

3. Fuel Inventory was Not Safeguarded Nor Fully Accounted For

The DHS Maintenance Section is not ensuring that the fuel inventory in its possession is safeguarded. Furthermore, there was no perpetual inventory record to show accounting of all receipts and issues including withdrawals by other departments.

4. DAS Has No Existing Credit Lines With Fuel Vendors.

Credit line would allow Chuuk State to pay only the fuel that was actually delivered and received.

5. Budget was not diligently prepared in each department considering all the services that should be adequately responded to by each department or division within the state.

Recommendations

We recommend the concerned department to:

1. **Reconcile Fuel Payments With Supporting Documents**

Since there was an absence of control in receiving fuel and accounting for fuel payments, DAS should reconcile the past transactions for fuel check payment with the corresponding supplier's invoice and receiving documentations to account for the full amount of each paid check. The DAS should consider requesting documents from the gas company if the necessary documents cannot be located from the internal files. The reconciliation procedure is necessary to ensure that the amount of each check payment was fully accounted for.

2. **Negotiate Credit Line with Gas Companies**

DAS should arrange for credit facility with fuel suppliers to avoid prepaying fuel purchases, which require additional administration job of reconciliation procedure.

According to CFCC, the fuel is no longer purchased from retail gas outlets on an advance payment basis effective May 1, 2009. Instead, gasoline, diesel fuel, kerosene and oil is be purchased from retail outlets on an open purchase order basis with payment made as fuel is used and invoiced by the gas station. The new process follows:

1. Departments deliver a purchase order to a retail gas station for a specified amount of POL.

2. A Fuel Authorization Form approved by the department is delivered to the retail gas station authorizing the outlet to issue POL to the department employee authorized on the Form.

3. The retail outlet would issue invoices to the department for payment.

The DHS Director added that the hospital is now taking action by ensuring that the fuel borrowed by other departments from DHS is properly recorded and would be returned or paid back.

3. **Implement Internal Control Procedures for Fuel Inventory Control**

The DHS and DAS should implement control procedures to control fuel purchase, receipt, and consumption. Such control procedures should consider the following:

a. DAS should prepare and issue receiving report confirming receipts of bulk fuel purchases. As required by the regulations, the receiving report should be attached to payment voucher together with the acknowledged supplier's invoice and delivery receipts establishing validity of fuel payment.

b. DHS Maintenance staff should log all the generator activities including fuel usages. Through daily inspection and signature on the log, the DHS Maintenance Supervisor should ensure that that the log is updated on daily basis. The log should also be properly filed for future reference purposes.

c. The DAS/DHS should provide accountability for fuel inventory to track the receipts, issues and inventory balances. Information about the payment voucher/purchase order, receiving report and other transaction references be recorded.

d. The withdrawal of fuel by other departments should not be allowed but if it could not be avoided, a request be formalized and the DHS maintenance staff responsible for fuel inventory should obtain the DHS Director's approval prior to releasing of fuel. Any intention (to repay or to charge DHS) should be clearly specified in the approval. The approved and served requests should be filed for references purposes.

e. DAS should develop and implement a procedure to immediately record and charge back other departments' fuel withdrawals to the appropriate cost center of the requesting departments.

f. DAS should ensure that all vouchers and records are filed properly and their whereabouts known anytime for reference purposes.

4. **Diligent Review of Fuel Budget**

All Departments, including DHS, should review and prepare their respective fuel budget needs considering the services that would be provided to all customers whether persons, organization or another departments or agencies.

Fuel emergency needs that are not budgeted should be processed under the required budget processes.

8. Lack of Accountability Led to Questionable Use of Revenue Funds Earned by DHS

The Fiscal Procedures Agreement (FPA) of the Compact requires that revenue earned through programs funded by the Compact be used only to support the program from which the revenue was earned. Additionally, the FPA requires complete and accurate financial reporting and proper stewardship of funds received. Specifically, the FPA states:

> *…unless otherwise authorized by the grant, program income shall remain with the programs in which they are earned, to offset operational costs and capital costs not covered by funds provided pursuant to the Compact, as amended….*
>
> And
>
> "*….financial reporting to be accurate, current, and shall have complete disclosure of the financial results of the U.S. funded activities and shall be in accordance with the reporting s of the Sector Grants..*[14]

Additionally, the Chuuk State Constitution requires budgets to be approved by legislature before funds can be disbursed. It states:

> *...the Governor to submit an annual budget to legislature containing a complete plan or proposed expenditures, anticipated revenues, and other monies available to the State Government for the next fiscal year...*
>
> And
>
> *…no Government funds shall be disbursed without authorization and appropriation by Chuuk Law…*" [15]

DHS earned revenues while performing some of the activities fully supported by Compact health sector grant.[16] Such revenue was earned by procuring medicines and supplies and then selling them to patients. In addition, the DHS also earned revenue by charging fees to patients for medical services performed by medical workers whose salaries were fully funded by Compact health sector grant.

[14] Section 1(a) (2) of Article VI of the FPA
[15] Article VIII, Section 4 of the Chuuk Constitution and Section
[16] The audit team could not determine or estimate the total revenue earned due to poor record keeping practices of the DAS.

The earned revenue should have been deposited in the health sector grant as required by the FPA. Instead, a separate account was established wherein the revenue was deposited within and such revenue was never reported to the concerned agencies such as the legislature, grantor, or national government, or to the public.

Furthermore, the audit revealed that medical revenue and the money expended (expenditures) from the fund were not properly accounted for. Specifically:

- The DAS official admitted that receipts have not been matched against the actual cash deposited to ensure all revenue was deposited.
- The official further admitted that collections have not been deposited in the bank on a daily basis during the last two years.
- The DAS official was unable to provide a complete file of payment transactions (expenditures). Only some payment records from 2005 were provided to the audit team.
- The audit examination of the available 2005 expenditure documents revealed that the fund was used for inappropriate payments such as travel, meals during function meetings, lease payment, fuel, training allowances, house rental, etc.

Table 14 below provides some examples of payments made from the account.

Table 14
Example of 2005 Medical Fund Account Payment

Payment Description Per Request	Amount	ONPA Comments
1. Emergency loan by Chuuk State paid to Chuuk Public Utility	$60,000	The supporting document indicated that payment was made per verbal instruction. Fund was used inappropriately.
2. Payment of land lease for the Pacific Health Building which is part of Chuuk Hospital	$10,000	There was no support except for a request letter from the property owner.
3. Payment of House Rental	$ 3,000	The supporting document did not indicate house rental bill but a judgment of a court for an offense committed. Fund was used inappropriately.
4. Dinner for PIHOA Meeting	$1,961	Fund was used inappropriately.
5. Payment of Fuel for generator – 795 gallons of diesel	$1,833	There were no supporting documents such as receiving report and invoice. The same amount appeared to have been paid twice since another check was issued on same date for same amount.

Source: Payments Checks and Supporting Documents from DAS

The DAS official provided the following annual revenue and expenditure figures. However, no other statements or detailed information was provided in Table 15 below:

Table 15
Medical Fund Account Revenue and Expenditures

Year	Revenue	Expenditures	Excess of Revenue Over Expenditures
2005	100,587	82,442	18,145
2006	57,380	68,070	(10,690)
2007	202,934	249,093	(46,159)
2008	229,424	242,134	(12,710)
Total	590,325	641,739	(51,414)[17]

Source: DAS. These figures were not audited by the ONPA[18]

The failure of DHS and DAS to comply with the FPA requirements jeopardizes future health sector funding. As a result of the non-compliance and the use of medical revenue for purposes other than the health program, the U.S. Department of the Interior could suspend payment to the sector. Without these funds, it is unlikely that Chuuk could continue to provide medical services to its residents.

The secrecy of the medical fund and the lack of accountability over its use also would erode public trust in the governmental system.

Causes and Recommendations

Causes

The problem in handling of the medical fund account was caused by many factors such as:

1. The initiative of the Executive branch in implementing the Administrative Order 12-2005[19] to create the Medical Fund Account was not presented for review to other branches of the government such as the Legislative and Judiciary branches to ensure that it complies with the intent of the constitution, laws and regulation. Furthermore, the yearly revenue and expenditure budgets for the operation of the medical fund account were not presented to the legislature for approval/appropriation before incurring the expenditures.

[17] The ONPA, via e-mail, requested that the DAS Chief of Finance provide an explanation as to the reason for the negative balance. The ONPA did not receive a response to the inquiry

[18] DAS was not able to provide any supporting documentation for the account balances. Therefore, the ONPA could not test the accuracy of the figures provided.

[19] The administrative order indicated that the medical fund account was established in pursuant to Section 7 of Article 111 of the Chuuk State Constitution.

2. The DAS Director and the DHS Director did not ensure compliance of the creation of the medical fund account with the terms and condition of the Compact agreement especially in terms of control and reporting of the results of medical fund financial operations.
3. There were no policies and procedures on how to handle the revenue operation of the fund. Moreover, there was no approved schedule of fees for services nor a price list for the medicines sold for reference. Furthermore, movements of inventory in the pharmaceutical area were not properly accounted for as means of counter-checking the accuracy of declared sales.
4. There was a lack of internal control procedures to provide assurance that obligations and costs comply with applicable law; funds, property and other assets are safeguarded; and revenues and expenditures are properly recorded, accounted for and reported. For example, there was an absence of review of the expenditures by the Chuuk State Compact Funds Control Commission (CFCC)[20] and a budget review by the Chuuk State Legislature to ensure that the medical fund account revenues and expenditures transactions are appropriate. Furthermore, the medical fund account revenues were not properly accounted for with official receipts and cash controls like matching of collections and deposits and timely bank reconciliations were not implemented. Lastly, proper bookkeeping that would ensure proper recording, summarizing, and reporting of the transactions and filing of documents were not maintained.

Recommendations

We recommend that:

1. The Administrative Order 12-2005 creating medical fund account should be presented for review by the executive office to appropriate branches of government to ensure compliance with the requirements of the constitution, state laws and regulations. The type of fund should be approved by the legislature so that appropriate fund accounting could be implemented, as whether this fund would be accounted for as enterprise[21] or proprietary fund or another government funds within health sector grant. Furthermore, the executive office should obtain authorization and appropriation of medical fund account budget (revenues and expenditures) before the funds can be used for disbursement.
2. The DAS Director should ensure that the terms of conditions of the Compact grant are complied with in the implementation of the medical fund account. These should include

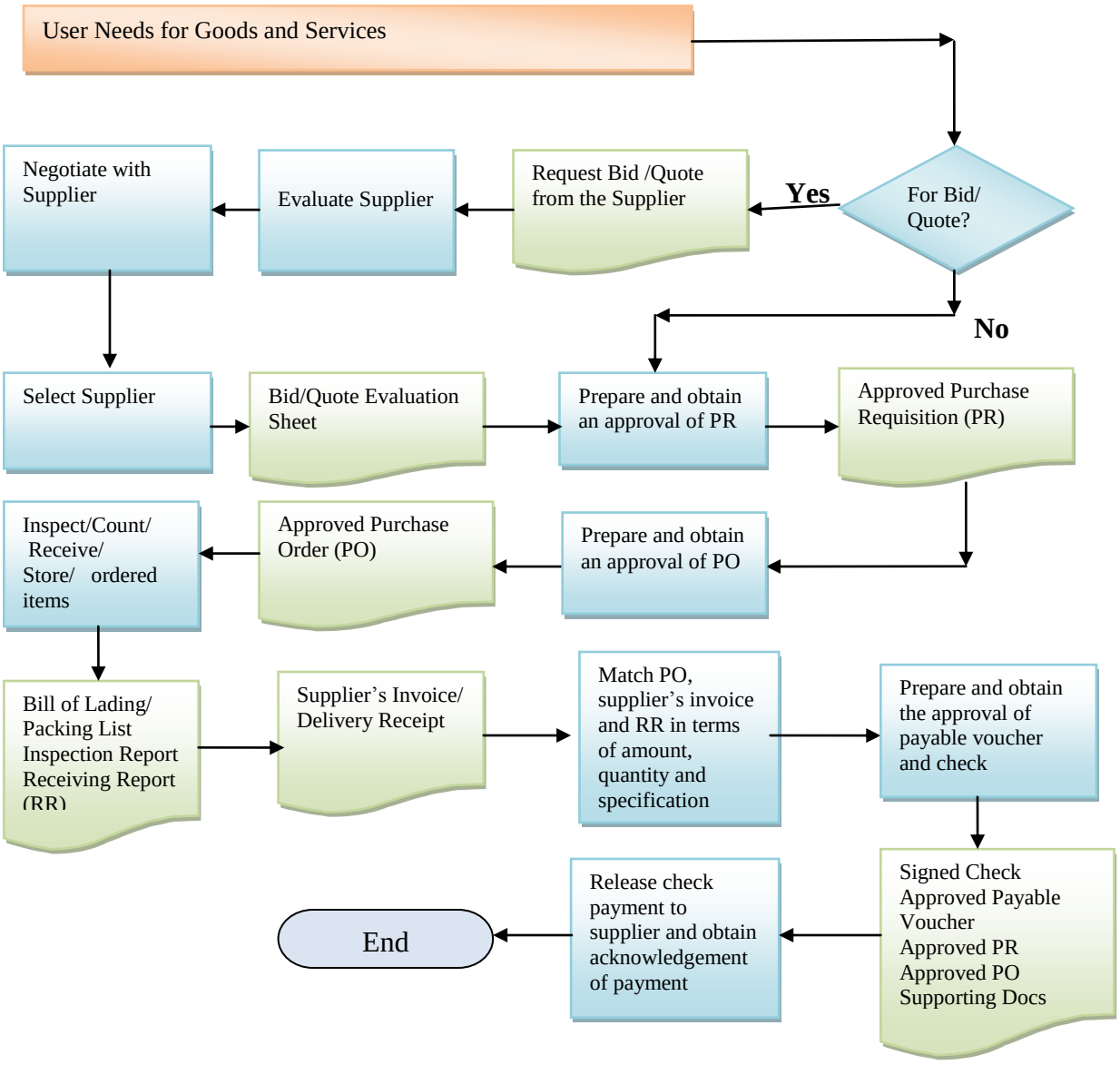
[20] The Chuuk State Legislature established the CFCC to provide greater reliability in amended Compact funds paid by the DAS. After the DAS has processed a transaction, CFCC reviews and approves the transaction to provide additional assurance that funds are available and expenditures are proper. This set up was implemented effective fiscal year 2006.

[21] Enterprise Fund Accounting – Used when a government wants to recoup all or a portion of the cost of providing services.

implementing of internal control policies and procedures for collecting of revenues, depositing of collections, accounting of receipts and sales of medicines at the pharmaceutical area, accounting of inventory at the pharmaceutical area to tie-up sales and inventory, spending of funds, budget control, bookkeeping, monitoring and reporting of financial activities.

3. The CFCC should review all payments from the medical fund account to provide greater control in ensuring that payments are appropriate.
4. The DAS to record the revenues and expenditures for the medical fund account in the same financial bookkeeping system that accounts for the funds of health sector grant. This would also ensure that the transactions from the fund account are properly reported

Appendix A Flowchart of the Procurement Process



MANAGEMENT RESPONSE

1. Response from DHS

CHUUK STATE GOVERNMENT
DEPARTMENT OF HEALTH SERVICES
State of Chuuk..
Federated States of Micronesia
96942

P.O. Box 400
Phone: (691) – 330 – 2216/2217
Fax: (691) 330 – 2320

Julio Marar, Director Dr. Abraham Ichik, Deputy Director Kania Marcus, Administrator

02/08/2010

Haser Hainrick
National Public Auditor
Office of the National Public Auditor
Palikir, FSM

Thru: Julio Marar
Director, DHS
Chuuk State, FSM

Dear Mr. Hainrick,

Please, find enclosed is my formal response to the draft audit report of Chuuk State Department of Health Services (DHS) Procurement and Inventory System (Report No.2009-07) issued on January 27, 2010. Authorized and requested by DHS Director Julio Marar, as the department procurement officer in-charge, although it may be too late, but for the record, this response will focus on both the recommendations and the general contents of the report.

But before doing so, please allow me to express my own perception or perhaps concerns over the audit report/results. Generally speaking, I agree with most (90%) of the findings, causes, and recommendations stated in the report. However, more could have been done to make it sound fair, accurate, and applicable.

1. Audit report-covering FY-2006-2008 (inventory management- March, 2009).... Should there be a significant reason/motivations for selecting the time frame, it should be first stated in the report, otherwise, public would perceived this compact period be the "worst ," as far as Health sector expenditures are concerned. The trends of activities (transactions) specific for each FY 2006-2009 to show progression (status) of procurement improvements and shortfalls were not address and identified in the report. Such information is vital to further investigate what programs/activities been effective or inefficient during the study period. Extending the audit period three or four year back could bring new findings which could have been of informative and beneficial to our current practice.

See 1 on page 55 for ONPA Evaluation of Response

2. Six dispensaries (8%) from Mortlocks region to sample (represent) the total 78 Dispensaries in Chuuk (page 7) are not ideal or strong enough to support any conclusion. It's even make more bias when the selection was confined to only one geographical region. The results could have been transparent and conclusive if a comparative study had been made with that of Nick Andon's (CFCC Office) survey of all the dispensaries in Chuuk State in 2007-2008.

See 2 on page 55 for ONPA Evaluation of Response

3. Non-availability of Essential Drugs (at the Dispensaries) RESULTED in Denial of Treatment and Possibly Deaths (page 9).
As much as I agree with the statement above, I would not recommend mentioning the specific medical conditions –causing deaths- resulting from unavailability of the essential drugs at the dispensaries, as reported by the Health Assistants. I thought all to be included in an audit report are supposed to be factual, not on assumption. The audit team failed to verify the incidents, nor identify the specific essential medications, needed to prevent the deaths for the specific cases. On other note, baby formula in not part of the dispensary essential medication. And there is no essential medication can save someone with Hepatitis B in its advanced stage.

See 3 on page 55 for ONPA Evaluation of Response

4. "Large quantity of expired medications suggests that funds are being wasted" (page 15.). At certain times during the past years, several visiting medical teams (CANVAS PAK, AYUDA FOUNDATION, JAPANESE MEDICAL TEAM, ARRT –USS MERCY TEAM,) also brought donated medicines and medical supplies, in excessive amount that would be expired on us. But again, with poor inventory and monitoring system you would not able to segregate these donated medicines.

See 4 on page 56 for ONPA Evaluation of Response

5. Purchases with Appearance of Conflict of Interest:
Generally we do not agree with the audit findings on the conflict of interest here as pointed out by the audit team. None of the assumed individuals/vendors cited in the audit findings has any direct involvement on decision making in the procurement process. In other words, none of the individual party/ vendor alluded to by the audit team have any direct saying/involvement in the procurement process.

See 5 on page 56 for ONPA Evaluation of Response

6. Unsound Procurement Practices Likely circumvented Competitive Procurement Requirement (page 22): While I can agree with most of the findings in such regards, I just want to verify that at least one of the outside vendor has been exempted from the competitive requirement by the Health Sector Grant Manager, and its POs had even been authorized to be more than $100.000.00 worth.
This particular vendor could be among those described in the sample study in the report. Back in early 2006, the hospital was in critical shortage of medical supplies and pharmaceuticals, hence several emergency orders were made, and was later authorized by the Health Sector Grant Manager. We have documents to support these transactions.

See 6 on page 56 for ONPA Evaluation of Response

Measures been undertaken to improve the Procurement Situation at DHS:

While we all agree that DHS suffered subsequences of lack inventory policy and standard procedures, during the course of audit process, certain measures and procedures had already been implemented to improve the situation.

1. Hiring of an Inventory Specialist- Should be on board in couple months.
2. Pharmaceutical Information System (PIS) WHO software for inventory purposes – on trial and soon to be effectuate when the Inventory Specialist is available.
3. Pre-qualification Process/Requirements of potential vendors entering bidding or do business with DHS- drafted by AG office.
4. Open Sealed Bidding (RFP) - been practiced (per CFCC recommendation) for bulk orders to minimize splitting of POs, thus comply with the FPA procedures on >$100,000.00 worth POs.
5. Rearrangements and cleaning of the Hospital Medical Store Room to meet inventory purposes.
6. CFCC involvement in validation of Price Quotations from outside vendors.
7. Improving filing records of procurement profiles.
8. Improving tracking system of Purchase Orders.
9. Measures taken to avoid overstocking of medicines and medical supplies.
10. Expired medications were taken off the shelves and will soon be disposed when our new incinerator arrives next month.

Above are our responses to some of the issues discussed in the Draft Audit Report of Chuuk State Department of Health Services for Procurement and Inventory Management System. We still believe that a better picture on the progress of our procurement system could have been achieved if the time frame extended back few years back.

Let us know should you need anything further from our end.

Thank you.

Bosco Buriche, DCHMS
Procurement Officer In-Charge
Pharmaceuticals and Medical Supplies
Dept. Of Health Services, Chuuk State

2. Response from DAS

DEPARTMENT OF ADMINISTRATIVE SERVICES
STATE OF CHUUK
Federated States of Micronesia

P.O. BOX 849
WENO, STATE OF CHK
F.S.M. 96942

TEL. (691) 330-2480
monjesse@yahoo.com

JESSE MORI
Director
JONAS PAUL
Deputy Director

ONPA - Audits
RECEIVED
Date 2/5/10

2.8.2010

DATE: February 5, 2010

TO: National Public Auditor

FROM Director, Chuuk State Department of Administrative Services

SUBJECT: Responses to *Chuuk State Department of Health Services' Procurement And Inventory Management System* Report.

Chuuk DAS is pleased to provide its attached responses to the subject audit. Please let us know if we can provide additional information or otherwise assist the issuance of your final report.

Thank you.

Jesse Mori
DIRECTOR, DAS

Cc: CFCC

Chuuk State Department of Administrative Services
MANAGEMENT RESPONSES
OPA Audit of Chuuk State DHS Procurement and Inventory Management System

FINDINGS #3. Medicines Purchased From Immediate Family Members of DHS Officials and Staff (p.16- 18)

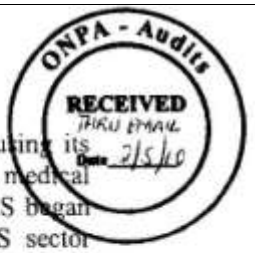
We agree with the finding and recommendation. We note that the exceptions cited for conflict of interest, however, pertained to non-disclosure violations rather than any improprieties involved in the specific pharmaceutical or medical supply procurements. In order to comply with both the FPA and *Chuuk State Financial Management Regulations* (FMR), Chuuk DAS will work with CFCC in devising the proper disclosure forms to document related party procurements where an employee is related to the owners of a business from whom DHHS makes purchases. Moreover, purchase requisitions evidencing real or apparent conflict of interest will be returned for proper approval by unrelated parties in DHHS.

FINDINGS #4. Approximately $700,000 Worth Of Purchased Medications Not Received

DAS agrees with the finding and recommendation. In order to correct this problem, a new policy generally prohibiting advances to vendors had been implemented effective October 1, 2009. DAS will research all cited cases of non-delivery and follow-up with the applicable vendor.

FINDINGS #5. Unsound Procurement Practices Likely Circumvented Competitive Procurement Requirements (p. 22-27)

DAS agrees with the finding and recommendations and notes that the conditions causing the purchasing deficiencies in prior years have now been corrected. Additionally, effective October 1, 2008, initial DHS procurement documents are reviewed and approved by CFCC before submittal to Chuuk DAS; a process that has provided independent internal verification that proper procurement policies and documentation of such are being adhered to. These policies include sufficiency and adequacy of bids or quotations, specific grantor agency approval for emergency procurements, no splitting of purchases to avoid bidding requirements, sufficient justification for vendor selection. DAS has also made revisions to its filing system whereby all documents supporting the procurement and payment process are attached behind the check copy. Additionally, since FY-08 , receiving reports are now used on all local purchases to evidence receipt of goods. Hence, DAS now has in place policies and procedures to support sound procurement practices.



Some of the bid/quote deficiencies cited pertain to a period when DAS was using its FMR for pharmaceutical procurement. These regulations specifically exempted medical supplies from competitive procurement. Beginning in FY-09 , however, DAS began following the FPA and its competitive procurement procedures for all DHS sector purchases, including pharmaceuticals and medical supplies.

We also note that for future DHS procurements, OIA's waiver of certain procurement rules in their letter of January 26, 2010, will remove some of the more fussy and impracticable practices that did not substantially contribute to better accountability and transparency of the hospital procurement process. Among these waivers was the practice of requiring another quote if one of the contacted three vendors cannot provide pricing information, the requirement for the use of "or equivalent" on quotations for small purchases where buying "brand name" is necessary, the requirement for providing written justification for the selection of vendors providing identical price quotes, the requirement for competitive quotations for emergency repairs, and the requirement to provide written justification in the event that a vendor's total price quotation for purchases of $5,000 or less is lower than the competition but one or two items are priced higher. DAS management is in full concurrence with OIA's waiver, feeling that by not having to concentrate on the minutiae *form* of compliance documentation, it will be easier to concentrate on the *substantive* issues of internal accounting control.

FINDING #6: Inventory Management at the Hospital (pp28-32)

Chuuk DAS has no authority over DHS warehouse inventory management. Moreover, Chuuk DAS does not have adequate staff to provide management of a perpetual inventory system at the hospital. This process is a full time job that must be performed by a DHS employee.

FINDINGS #7. Lack of Control Over Fuel Purchases Resulted in 70% Increase in Fuel Spending During Two Year Period (pp. 33-39)

DAS management agrees about the inadequacy of documentation supporting DHS bulk fuel purchases and that it did not prepare receiving report for every receipt of fuel delivered by Mobil or FSM Petroleum to DHS. The crux of the problem was having to advance cash to FSM Petroleum before receipt of the fuel because they would not accept State checks. The initial check prepared by DAS was based on prices from proforma invoices but actual deliveries were separately priced at the new prices prevailing at the time of delivery. So there would be multiple deliveries during different days under different prices that pertained to one advance Hence, it has been extremely difficult to match up vendor invoices with the initial advance check and this was not always done. Moreover it has not been practicable to have DAS procurement personnel available for every bulk delivery; receipt was confirmed by DHS staff signatures on the supplier's invoice.

To implement control on fuel purchases in bulk, DAS has instructed DHS personnel to submit copies of all corresponding procurement documents related to the purchase (such

as cashiers check, deposit slip and supplier's delivery and invoice with confirmation of receipt) immediately after receipt of fuel to be filed along with MPR, PV, PO, Check and other procurement and transaction documents. These documents are required before DAS will make a new advance. This procedure has been effective for properly documenting bulk fuel deliveries thus far in FY-2010.

FINDINGS #8. Lack of Accountability Led to Questionable Use of Revenue Funds Earned by DHS.

DAS agrees with the findings and generally with the recommendations except as noted below. The previous off-book nature of these transactions were a concern with the State's external auditors and corrective actions were already in progress at the time of the audit. Effective in FY-09 DAS began recording deposits and expenditures of DHS special revenue in a specific revenue fund created for that purpose. DAS is also aware that in addition to DHS collections, the proceeds of special regional, non-recurring grant awards by third parties were also deposited in this account. DAS also accounts for these in the special revenue fund created for DHS local collections. This fund provides a proper accounting of all DHS special revenue transactions and forms the basis of a proper filing system in finance. DAS is also preparing bank reconciliations of this account. Chuuk DAS does *not* have sufficient staff, however, to reconcile DHS inventories with the sales and receipts and believe that inventory management must remain a function of DHS staff.

It is correct that these revenues were not reported as program income on health sector quarterly reports because of specific instructions from the grant manager that it was not necessary based on her knowledge of the use and purposes of this account and the desire to allow maximum departmental flexibility to expend for special needs. We note that payments specified in Table 14 of the finding are expenditures for purposes included in the list of eligible uses provided in the Addendum to Administrative Directive No. 12-2005. Insofar as these revenues are not considered sector program income (and have no sector matching component), the expenditures will not be submitted to CFCC for approval.

It has been the general practice in Chuuk for the Chuuk State Legislature (CSL) to allow special departmental revenue not deposited in the general fund to be expended without appropriation. Nevertheless, we will research the current practice with the Budget Office and CSL officials and determine if there are special reporting requirements that need to be implemented concerning these funds.

3. Response from CFCC

COMPACT FUNDS CONTROL COMMISSION
P.O. BOX 1345 • WENO, CHUUK • FM 96942
PHONE: 691.330.4605 / 4960 • FAX: 691.330.4763

February 4, 2010

2.8.2010

National Public Auditor
Received
Date 02/08/10

To: Haser H. Hainrick
National Public Auditor

From: Alan Burnham
U.S. Representative, CFCC

Subj: Audit Report No. 2009-07,
Audit of Chuuk State Department of Health Services
Procurement & Inventory Management System

Greetings Haser:

All of us at CFCC want to thank you for including us in the recent exit conference here in Chuuk. Your findings, recommendations and the discussion during the conference will help us in our compliance review of Compact funded procurement.

Following are our comments concerning recommendations that directly effect daily operations at CFCC.

Page 18: 3.2. Recommendations

Report
We recommend Chuuk State DAS and DHS should:

- Develop the necessary control procedures to enforce the conflict of interest provision of the regulations and to ensure the integrity of the procurement process from solicitation to evaluation and selection of the winning bid/quote for the procurement that would involve conflict of interest.
- Develop and implement policies and procedures that would also require supplier/vendor/contractor to identify employees to whom they are related.

Response
Since CFCC is the first stop in the routing process and the reviewer of all Compact documents, we are working with DAS and DHS to develop a methodology to identify and disclose conflicts of interest. In that regard we have obtained from the Chuuk branch of FSM Tax and Revenue a list of businesses and their owners as evidenced by current Import/Export licenses and have also developed a check list with a number of criteria to assist in identifying conflicts. We are also working on a disclosure format that will satisfy the requirements of the Compact FPA and the Chuuk FMR.

Page 27: 5.1. Recommendations

Report
The DAS and DHS office should be more diligent in its documentation to secure PO adequate support and explicit override approval with justification should be attached to the voucher when any procurement is done outside of the requirements of the regulations or FPA agreements. Without such documentation, the offices cannot support that it has been following its own policy to obtain competitive pricing.

Response
During January 2010, the Office of Insular Affairs-Honolulu Field Office gave written authorization for the use of two price quotes in the situation where three vendors are contacted and one of those vendors is unable to provide a price quotation and the circumstances are documented. This information has been provided to the Departments and CFCC can ensure that a copy of the OIA waiver is attached to the package of procurement documents.

Page 44: 8.3. Recommendations

Report
The CFCC should review all payments from the medical fund account to provide greater control in ensuring that payments are appropriate.

Response
The Health Services Grant Manager has stated that 1) she does not require reporting on collections in the medical fund account, 2) account information has always been available to her, 3) she was involved in determining specific uses of the money and 4) she has no issues with payments thus far.

CFFC would need to discuss this recommendation with the Health Services Grant Manager before implementing a payment review process.

Thank you,

Alan Burnham, CPA

ONPA EVALUATION OF MANAGEMENT RESPONSE

The ONPA offers the following comments regarding the audit response provided by DHS.

1. Standard audit practice is to review records for the three year period preceding the audit. In conducting performance audits, audit teams must evaluate workflow processes at the time the audit is conducted which entails including the current year to date. Therefore, the audit report covered FY 2006 – 2008 as well as a portion of FY 2009.

2. DHS did not provide the ONPA with a copy of the CFCC survey conducted in 2008 nor did DHS indicate that a study had been conducted. Therefore, results of the study were not used during the audit. Moreover, because DHS did not maintain complete records of deliveries made to island dispensaries, the ONPA could not use delivery data in its analysis.

   It should be noted that one role of a public auditor is to help ensure government officials are aware when services are not being provided effectively and efficiently to the government's constituents. Whether the ONPA survey of six dispensaries in the Mortlock region is representative or not is not relevant. The report highlights that in at least one of Chuuk's regions, the constituents are not receiving basic medical care and that improvements to the inventory management and distribution system are needed.

   To ensure fair and objective reporting, upon receiving the DHS response and learning of the CFCC the ONPA requested copies of those reports so that it could include relevant information herewith. The ONPA received two reports: Assessment Report of Dispensaries in the Faichuk Region July 21 to July 25, 2008 and Assessment Report of the Dispensaries in the Southern Namoneas Region January 12 to January 21, 2009.

   In completing the reports, the CFCC representative interviewed Health Assistants and asked the Health Assistants to comment on the sufficiency of medications. Inventory counts were not completed. For each dispensary, the reports provide general statements such as "Yes, there are enough medicines," "Some medicines and medical supplies," and "Only a few medicines…" The ONPA tallied the results and found that in the Southern Namoneas Region (often referred to as the lagoon region) 13 Health Assistants reported having enough medications and three reported that they did not have enough. In the Faichuk region, farther from Weno than Southern Namoneas, only three Health Assistants reported having enough medications while 23 reported that they had 'some' or 'few.' The CFCC results provide additional evidence that the farther a dispensary is located from Weno, the less likely it is to have medications available when needed. This confirms that improvements to the inventory management and distribution system are needed to ensure all Chuukese have access to medical care.

3. The ONPA disagrees with the DHS' comment that the audit report includes assumptions. The audit report includes the testimony of Health Assistants and, in doing so, the audit

report acknowledges that the Health Assistants lack the training and equipment to make conclusions regarding the cause of death. Specifically, page nine of the report states "Though not qualified to make an assessment as to the cause of death of a patient, the Health Assistants on several islands reported incidences when the lack of needed medications and supplies may have contributed to the unnecessary deaths of patients." Furthermore, footnote three then states "The incidents listed below are presented as exhibiting a correlation between the lack of medication and supplies and the subsequent deaths. The ONPA is not qualified nor was information available to evaluate the extent to which causal relationships may have existed." Footnote 4 further reports that "The ONPA could not verify the accuracy of these statements."

The ONPA acknowledges that baby formula is not part of the dispensary list of essential medications, as mentioned in the DHS response. The DHS response also stated that … there is no essential medication can save someone with Hepatitis B in its advanced stage." The ONPA lacks the medical qualifications and case knowledge to comment whether the patient's Hepatitis B would have reached an advanced stage if the medication had been available.

4. The donation of medications may have contributed to the expiration of large quantities of medications.

5. The ONPA believes that the details included in the examples provided on pages 16 and 17 sufficiently demonstrate the existence of conflicts of interest in the purchasing process.

    - The Health Sector Grant Manager may have made an exception to the competitive purchasing requirement in the case described in the DHS response. If an exception or other allowance is made by the grant manager, the department should maintain a written record of this decision. Specifically, purchase files should contain copies of any e-mail correspondence from the grant manager that documents approval to proceed in a manner that does not comply with the standard requirements.

NATIONAL PUBLIC AUDITOR'S COMMENTS

We would like to thank management and staff of Chuuk State Department of Health Services, Chuuk State Department of Administrative Services, and Compact Funds Control Commission for their assistance and cooperation throughout the course of the audit.

In addition to providing copies of the final report to the FSM President and members of the FSM Congress, we also sent copies to the following officials:

- Governor and Lt. Governor, Chuuk State
- President, Speaker and Members of Chuuk State Legislature
- Secretary of Finance, FSM National Government
- Secretary of Department of Health and Social Affairs, FSM National Government
- Director, Department of Health Services, Chuuk State
- Director, Department of Administrative Services, Chuuk State
- Director, Chuuk State Public Service Commission
- Compact Funds Control Commission, Chuuk State

Furthermore, 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 our Office. Contact information for the Office can be found on the last page of this report, along with the National Public Auditor and staff who made major contributions to this report.

Haser H. Hainrick
National Public Auditor

February 10, 2010

ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

ONPA CONTACT	Haser H. Hainrick, National Public Auditor Email: hhainrick@fsmopa.fm
ACKNOWLEDGEMENTS	In addition to the contact named above, the following staff made key contributions to this report: Eric Spivak, Audit Manager Manuel L. San Jose, Jr. Audit Supervisor Erwhine David, Auditor-In-Charge Evelyn Paul, Staff Auditor
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