

**AUDIT OF THE NATIONAL FISHERIES CORPORATION  
(FISCAL 2012)**

**Report 2012-05**



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## **INTRODUCTION**

### **Background**

The National Fisheries Corporation (NFC) was established in 1983 under Public Law No. 3-14 to develop the pelagic fisheries industry in the Federated States of Micronesia (FSM). It started as a fully functioning corporation in fiscal year 1987, started its first fisheries project in FY 1990, and has been operating as a public corporation and an agency of the FSM government for fisheries development for the past 25 years.

The NFC is managed and controlled by a Board of Directors<sup>1</sup> (the Board) consisting of seven appointed members who have service terms of four years. All of the day-to-day administrative and management functions of the corporation are carried out by the Chief Executive Officer (CEO), appointed by the Board, with the supporting staff.

The Corporation's finances are managed independent of the FSM national government and are operated under a budget approved by the Board. The company generates its own income while periodically receiving subsidies from the FSM national government.

### Operations

During the peak of its operation in the mid-90s, the NFC fisheries programs have consisted of the five main operations: Corporate Overall Management Office, Transshipment Operation, and the Long Line Fishing Operation, Bait & Supplies Services, and Air Freight Chartering services. Except for the Transshipment Operation, all the operations have suffered losses rendering the company's inability to pay debts with both local and off island vendors and loans with the FSM National Government. The Board and Management over the years have tried to streamline NFC operations and all of its operational programs to help curtail its accumulated debts; however these efforts have been unsuccessful and NFC is now faced with a major financial problem of being a corporation with no current ability to pay off its debt.

The enabling legislation placed particular emphasis upon fostering private enterprise in the commercial development of fisheries. It is for this reason that NFC engaged in joint ventures in the past; Yap Fresh Tuna Inc. (YFTI), Chuuk Fresh Tuna Inc. (CFTI), Kosrae Sea Ventures Inc. (KSVI) and Micronesia Long line Fishing Co. (MLFC). Except for MLFC, which declared bankruptcy in 2005 and is currently under receivership, all these joint ventures have ceased operations prior to fiscal year 2005. The Company has incurred substantial losses from its investments with YFTI, CFTI, KSVI and MLFC, that severely affected NFC's operations. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

Recently, the NFC management established a joint venture with a Japanese purse seiner company, New Eikyu Gyogyo Co., Ltd, and formed Kasar Fishing Corporation (KFC), a purse seiner

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<sup>1</sup> One member appointed by the President of the FSM, one appointed by each of the Governors of the States of FSM, the Executive Director of the National Oceanic Resources Management Authority, and the Secretary of the Department of Resources and Development who shall serve as an ex officio member and who shall have no power to vote except in the event of a tie.

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company to operate and fish in the FSM EEZ and areas under the FSM regional agreement. The expectation for this joint venture was to generate sufficient added income for NFC to become a self-supporting company in the years to come.

Other Matters

On June 10, 2007 and May 28, 2009, Senators introduced two Congressional Bills (C.B. No. 15-44 & 16-21) in the FSM Congress to convert unpaid NFC loan balance of \$3.6 Million from the FSM national government into grants. The FSM Congress did not pass the bills. Before this, the FSM President submitted presidential communications, dated June 2 and 8, 2008, to the Speaker of the FSM Congress expressing concerns on the ability of the NFC to continue operations and to declare the entity bankrupt. The FSM President has likewise instructed the Secretary of the Department of Justice (DOJ) to initiate bankruptcy proceedings.

**Objective, Scope and Methodology**

Objectives - We conducted this audit at the request of the NFC Chairman of the Board to initiate a compliance and management audit. Furthermore, we performed an audit survey that led to identification of the focus areas of this audit: Management, Planning and Control activities, protection of Fixed Assets and Cash Receipts, and the process leading to investment in Joint Ventures. Therefore, we focused our audit objectives on the following areas:

- To determine whether NFC implemented planning and monitoring controls to ensure the achievement of its goals and objectives based on enabling legislation.
- To determine whether NFC followed a process to ensure adequate basis in deciding joint venture agreement or other business undertakings.
- To determine whether NFC implemented sufficient controls to safeguard its assets and cash receipts.

Scope: This audit covered the review and observation of existing management controls in planning and monitoring as well as the process leading to major business decisions. We also examined sampled transactions, documents, and reports in fiscal years (FY) 2010 and 2011 to verify the operation of controls.

Furthermore, we analyzed and summarized information in prior years audited financial statements. We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. In addition, we conducted this audit, pursuant to the authority vested in the Public Auditor as codified under Chapter 5, Title 55 of the FSM Code, which states in part:

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*“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.”*

**Methodology:** We conducted our audit fieldwork at NFC Office in Kolonia, Pohnpei. To satisfy our audit objectives, we performed the following methodologies.

- To determine whether NFC implemented planning and monitoring controls to ensure the achievement of its goals and objectives based on enabling legislation, we obtained and reviewed relevant laws, regulations, processes, policies and procedures for NFC. Likewise, we also interviewed NFC Board members, CEO and staff who have played significant roles in implementing the planning and monitoring controls
- To determine whether NFC implemented sufficient controls to safeguard assets, we obtained and reviewed the internal control policies and procedures related to assets. In addition, we observed, inspected and judgmentally selected transactions and reports to verify sufficiency of controls on assets.
- To determine whether NFC followed a process to ensure adequate basis in its major decisions like the joint venture agreement, sale of assets, and other business undertakings, we obtained, reviewed, and analyzed the decision making process, policies and procedures, and any related process. We also interviewed the previous and current CEO, and the Chairman of the Board.

### **Prior Audit Coverage**

Deloitte & Touche LLP, an external auditor, performed an annual audit<sup>2</sup> on NFC financial statements as far back as 1992. The single audit finding in fiscal year 2011 related to our audit objectives was regarding accrued employee leave balances that were paid out (converted to cash) to employees without Board’s approval.

In addition, the ONPA performed an audit in 1999 to analyze the financials of NFC. The audit concluded then that NFC was “...*not financially or operationally viable*.”

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<sup>2</sup> An examination performed by an independent auditor to express an opinion regarding the fairness of presentation of the financial positions (balance sheet), results of operations (income statement), and the cash flows reflected in the financial statements.

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**Conclusion**

Based on our audit, we concluded that the NFC Board and Management did not provide adequate supervision over the operational duties in carrying out their key activities in managing the corporation to become a profitable company. Consequently, the following weaknesses existed:

- Lack of Strategic Development Plan to provide corporate direction
- Inadequate Annual Budget Plan that failed to implement strategies on how to achieve goals and objectives
- Absence of performance measures to implement and monitor the achievement of goals and objectives
- No negotiation process manual in place to promote sound and justifiable decision making on joint ventures and other business undertakings
- Inadequate segregation of duties led to undetected errors
- Insufficient controls for payroll processing increased the risk of abuse and violation of law
- Insufficient controls and safeguarding of fixed assets led to missing and unaccounted fixed assets

Ultimately, the NFC did not implement planning and monitoring controls to ensure the achievement of its goals and objectives based on its enabling legislation. In addition, they did not follow a process to ensure adequate basis in deciding business joint ventures or other business undertakings.

We discussed our findings and recommendations in details on the following pages.

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## **FINDINGS AND RECOMMENDATIONS**

### **Finding 1: Lack of Strategic Plan to Provide Corporate Direction**

Prudent management practice requires an organization to engage in strategic planning process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. In addition, it shall have a strategic development plan that includes key components such as Vision, Mission, Goals & Objectives, Strategies and Performance Measures.

We found that NFC has been operating without its own Strategic Plan in place to provide corporate direction. According to the previous CEO, an Interim Plan<sup>3</sup> was developed in 2006 during his time in office (2003 – 2011) to present the current financial status and to recommend appropriate restructuring alternatives for the company for the FY 2006–2008. However, lack of funds prevented the implementation of the plan.

In addition, the Board neither made any update to the previous interim plan nor created a new plan to give the company some directions. The Board has indicated in their annual meetings<sup>4</sup> that the NFC needed a plan yet took no initiatives to develop one.

Without any corporate plan, NFC was provided with inadequate direction to drive operational planning, resource allocation, results setting, or development/implementation of strategies. It was not clear whether NFC pursued the right direction and efforts in achieving its short term and long-term objectives and their mandates<sup>5</sup>. Fisheries is one of the nation's valuable resources that require effective planning and management in order to realize its maximum potential and economic benefits.

#### **Cause and Recommendations**

The Board failed to adopt and implement any plan whether an interim or strategic plan. In addition, the function of the Board relative to planning is not well defined. We found from the review of the function of the Board based on the bylaws and enabling legislation that key functions related to planning are lacking the following functions:

- Reviewing and guiding corporate strategy (beyond the current year), major plans of action, policy, annual budgets and business plans,
- Setting performance objectives,
- Monitoring implementation and corporate performance and,
- Overseeing major capital investments

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<sup>3</sup> A set of task start and finish dates that you can save at certain stages of your project. You can compare an interim plan with the baseline plan or current plan to monitor project progress or slippage.

<sup>4</sup> Board Minutes March 24, 2008

<sup>5</sup> Refer to Appendix A

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We recommend

1. The Board should use strategic development planning process and to require the development and implementation of a Strategic Plan specific to NFC mandates and needs.
2. The President and Congress to review NFC's strategic plan and to set general corporate direction for NFC to pursue.

**Finding 2: Inadequate Annual Budget Plan that Failed to Implement Strategies on How to Achieve Goals and Objectives**

*24 FSMC, Chapter 7, subchapter 719 on Budget Preparation requires the Executive Director to prepare in advance of each fiscal year an annual budget for the corporation, taking into consideration anticipated capital, anticipated revenue, and operational expenditure. The annual budget shall be reviewed and approved by the Board.*

Furthermore, prudent management requires that profit seeking entities should develop annual budget plan setting forth its strategic activities and budget allocation to achieve its corporate goals and objectives. The annual budget plan should describe the expected month-to-month route a company will take in achieving its goals. In addition, the for-profit company's annual budget plan should include the key components such as the Operating Budget (Sales Budget, Administrative Expense Budget and Budgeted Income Statement) and the Financial Budget (Budgeted Balance Sheet and Budgeted Statement of Cash Flow).

The NFC, a profit oriented company, has an inadequate annual budget plan that does not use the annual budget as a planning tool to set its strategic activities and to allocate its resources in order to achieve its goals and objectives. Its budget does not differentiate the cost of revenue from the operating expenses. The budget focused more on the operational expenditure which is similar to a budget of a government department that is not required to generate revenue and earn a profit.

In addition, NFC's annual budget is missing key components of an annual budget. Although the NFC's budget plan includes an *operating budget* and the *financial budget*, the essence of each main component is missing<sup>6</sup>.

As a result, NFC has not been generating enough revenue to earn a profit, has incurred losses every year from FY 2003 - 2007<sup>7</sup> and has had negative cash flows since FY 2003 – 2011<sup>8</sup>.

**Cause and Recommendations**

The Board did not implement a meaningful budgeting system that focuses on profit maximization. Without the supporting plan for the revenue generating activities, its annual budgets merely show revenue and net profit but without substance.

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<sup>6</sup> Refer to Appendix B

<sup>7</sup> Refer to Appendix C

<sup>8</sup> Refer to Appendix D

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Furthermore, the Board does not segregate the for-profit and not-for-profit operations in NFC annual budget. Expenditures incurred on its not-for-profit operations hurt the bottom line for its for-profit operations.

We recommend that the Board should:

1. Use an annual budgeting system that is more appropriate to the operational needs of the corporation. In addition, the budget process should have all the requirements needed for a budget.
2. Segregate the profit and non-profit activities in the annual budgets so that appropriate performance measures and accountability for each classification of activity (for-profit and not-for-profit) could be set up and implemented.

**Finding 3: Absence of Performance Measures to Implement and Monitor the Achievement of Goals and Objectives**

*24 FSMC, Chapter 7, subchapter 719 on Records and Reporting requires that the Executive Director shall prepare and submit a monthly report to the Board. The monthly report shall include, inter alia, a monthly financial report. The Corporation, through its Board, shall make a quarterly report to the President of the FSM, and Speaker of the Congress of FSM.*

Furthermore, best practice indicates that monitoring controls are essential for a company to evaluate outcome and objective measures and strategies annually, or more frequently if data collection cycle permits, to track progress toward key outcomes and objectives. In the evaluation process, company assesses the effectiveness and efficiency of their operations and makes adjustments in strategic plans, use of resources, and operating procedures to improve results.

We found that Management was not submitting their monthly report to the Board and the Board has not been doing any quarterly financial reports to the FSM President and the Speaker of FSM Congress.

In addition, the NFC did not have performance results/measures in place on which to implement monitoring controls. They were unable to identify any improvement made and ascertain the achievement of goals and objectives.

As a result, the Board, FSM President and FSM Congress were not aware of how NFC has been performing in terms of specific requirements and measures. Furthermore, FSM President and FSM Congress could fail to address any recommendations on future policy based on performance targets.

In addition, the lack of board monitoring also resulted in NFC's failure to demand compliance with current Joint Venture Agreements (JVA) with a foreign company. For example:

- Unaccounted 20% share in joint venture profit. The NFC did not receive the agreed profit sharing yet the Board did not discuss the status of this issue in its regular meetings.

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- The foreign partner transferred \$15,000<sup>9</sup> or 5% ownership in the Joint Venture Company to former NFC CEO without the consent of NFC in violation of the JVA agreement. Per the Chairman, NFC only learned of the transfer when his department (FSM Resource & Development) was processing foreign investment application which indicated the 75% share instead of the 80% share.

**Cause and Recommendations**

The Board did not require the development of performance measures, management information or report system to ensure that the NFC would achieve mandated goals and objectives. Consequently, no monitoring was in place to track the progress of the NFC performances.

We recommend

1. The Board (a) to set up appropriate performance indicators and measures and (b) to implement adequate monitoring activities, to ensure the achievement of corporate goals and objectives and compliance with the requirements of the laws, regulations and agreements
2. The FSM Congress to revisit the enabling legislation that created NFC and clearly define the mandated roles and responsibilities of the Board related to management and oversight functions

**Finding 4: No Negotiation Process Manual in Place to Promote Sound and Justifiable Decision Making on Joint Ventures and Other Business Undertakings**

Prudent practice states that an effective judgment process should be logical, flexible, unbiased, objective, and consistent. It shall utilize appropriate amount of relevant information, and shall balance experience, knowledge, intuition and emotion. As basis for good business decision, the judgment process shall include reference to a due diligence study, business plan, internal and external assessment to assure complete information and that the company has the resources, management and work-force ability to run prospective business or investment.

We found during our review that the Board has not formally adopted a negotiation process or a judgment process that would ensure sound, quality, and justifiable judgment. According to the previous CEO, current CEO, and the Chairman of the Board, the practice in deciding investment in joint ventures has been limited to the review of proposals, consisting of brochures and letter of intent, submitted by interested parties. They did not guide themselves with any criteria. The Board neither required diligence study nor business plan and internal<sup>10</sup>/external assessment to assure them of adequate information for decision-making.

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<sup>9</sup> Estimated amount based on \$300,000 total stock capitalization per JVA

<sup>10</sup> Includes an inventory of work force skills (staff and managerial) to assure handling of the operation prospective business

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The previous CEO expressed to the Board the need for negotiation policy manual during one of its regular meeting<sup>11</sup>. However, the Board has yet to adopt and implement one.

As a result of failing to adopt negotiation process, there was no assurance that any past or current Board has been making business decisions in good faith with reasonable skills, prudence and justification. The Board has made various decisions on investments in joint ventures in the past without the benefit of a negotiation or judgment process. Consequently, some of the said joint ventures have ceased operations and contributed to substantial losses and NFC's unpaid \$3.6 million debt.

**Cause and Recommendations**

The Board did not make it a requirement to have a negotiation process manual in place.

We recommend the Board to create a negotiation manual as guidance to acquire the best deal with joint venture companies.

**Finding 5: Inadequate Segregation of Duties Led to Undetected Errors**

The generally accepted principle on internal control considers segregation of duties as a key concept of internal control for the prevention of fraud and errors. Prudent practices categorized four basic organizational functions for separation, which include: (1) *authorization*, (2) *custody*, (3) *record keeping* and (4) *reconciliation* to prevent a situation where one person perform and conceal errors and/or irregularities in the course of performing the day-to-day activities. However, in a small organization where proper segregation of duties is hard to implement, compensating controls<sup>12</sup> should be in place.

Based on our evaluation of the segregation of duties, we found that the Comptroller has been doing incompatible activities. In the areas of handling cash receipts, cash disbursements, payroll processing, and fixed assets, the Comptroller concurrently handles the *custody*, *recording*, *authorization* and *reconciliation* functions (refer to Appendix E for the details of identified incompatible duties). Furthermore, the Board did not implement compensating controls to reduce the risk of errors and irregularities caused by the inadequate segregation of function.

As a result of having one person performing multiple incompatible duties, errors and irregularities could be concealed. The risk of fraud and errors is increased. For instance, we found various errors in disbursements, receipts, journals and reconciliations that escaped detection. The details were shown to, and discussed with Management.

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<sup>11</sup> October 2009 board meeting

<sup>12</sup> Controls intended to reduce the risk of an existing or potential control weakness.

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**Cause and Recommendations**

The Board has not made an assessment and evaluation of internal control hence, did not implement adequate principle of segregation of duties to provide an appropriate level of checks and balances especially within the accounting and finance division.

We recommend that the Board should assess and implement strong internal or compensating controls thru proper segregation of duties especially at the accounting/finance division. Being a small entity, the chief executive officer should increase his role to monitor and review the Comptroller's work performance.

**Finding 6: Insufficient Controls for Payroll Processing Increased the Risk of Abuse and Violation of Law**

The *NFC's Personnel, Finance and Administration Policy and Procedure Manual* requires that all application forms for overtime work and annual leave require an advance approval by the CEO<sup>15</sup> except in unanticipated emergencies when prior approval may not be required.

In addition, prudent practice requires payroll processing to have proper documentation and accurate monitoring of employees work hours. Furthermore, deductions of income withholding and social security taxes are required by law.

For payroll transactions for FY 2010 and FY 2012, we judgmentally selected payroll months (October 2011 – March 2012) that covers Pay Period 1 – 10, and examined the detailed payroll transactions of all (six) existing NFC employees. Based on the results of our testing, we found that no sufficient controls were in place for payroll processing. We observed the following conditions demonstrating control weaknesses:

- We found that employees were being paid sick leave, annual leave and overtime without the request forms attached to support timesheets that would confirm approval of leave by management.
- Although the sampled timesheets were with indication of the actual annual leave and sick hours availed by each employee for each pay period, the Comptroller did not compute and indicate the leave balance available after each period. Furthermore, he is not maintaining subsidiary ledger for each employee annual and sick leave. Thus, the Comptroller did not adequately monitor the leave balance for each employee.
- The Comptroller paid the unused annual leaves amounting to \$9,980 in FY 2011 to employees without Board's approval.
- The Comptroller did not deduct his income withholding (pay period 5-11) and social security taxes (pay period 5-7) from his salary. Per the Comptroller's employment contract signed by previous CEO, he is exempt from tax deductions. However, it is not in compliance with statutory law.

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<sup>13</sup> Executive Director in the manual

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As a result, the risk of violation of law and abuse on withholding and overpayment of salaries and benefits is increased. Furthermore, the possibility of actual absences or tardiness were paid or not charged to annual or sick leave which leaves the leave balances un-changed.

In addition, we noted that the previous CEO received full salary at the same time from both NFC & Kasar<sup>14</sup> for 3 months during his transitional period<sup>15</sup> (October 2011 – December 2011).

- During the transitional period for the previous CEO in moving from NFC to Kasar, NFC paid him \$8,029.34 while Kasar paid him \$12,000.00 for the 3 months transition period. Thus, the combined salary of the former CEO received from both companies was about \$7,300 monthly or a total of about \$21,300 for 3 months.

**Cause and Recommendations**

The Management did not implement sufficient policies and procedures to monitor payroll hours, gross, deductions, benefits and the annual leave and sick leave balances.

We recommend that the Management should review and update the policies and procedures in the Payroll section of the Administration Manual to implement adequate control in payroll processing.

**Finding 7: Insufficient Controls and Safeguarding Led to Missing and Unaccounted Fixed Assets**

The NFC *Personnel, Finance and Administration Policy and Procedures Manual* require that fixed assets may only be purchased on the prior approval of NFC Board<sup>16</sup>. Standard internal control also requires that the board should approve the sales of fixed assets. It also requires the CEO to be responsible in ensuring that assets of the Corporation are safeguarded at all times by maintaining adequate security and insurance programs<sup>17</sup>

Furthermore, standard internal control on fixed assets requires the deletion of fixed assets from the asset listing, for whatever reason, be approved by the Board. Also, the periodic internal verification (count) is to be performed to examine existence and condition of fixed assets. Lastly, the equipment and furniture and fixtures to have identification number (asset tag number) to protect against loss

We found during our audit observation, physical inspection and testing that control deficiencies in handling and safeguarding of fixed assets resulted in the following:

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<sup>14</sup> As the bookkeeper of KASAR pursuant to the management services agreement between NFC and KASAR, the expenditures of Kasar like payroll are known to NFC Comptroller.

<sup>15</sup> The former CEO resigned from NFC to assume a position at KASAR effective January 2012. The resignation should be effective October 2011 but the NFC Board Chairman prevailed upon him to stay for a transition period to give time in finding his replacement and for the turn over. The NFC Board Chairman, for this short period service, signed the former CEO employment contract. According to the chairman, he has no knowledge then that the former CEO will also receive full salary from KASAR during the transition period.

<sup>16</sup> Page 37 Finance and Administration Manual

<sup>17</sup> Page 38 Finance and Administration Manual

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- We were unable to locate some fully depreciated fixed assets listed in the fixed assets register. According to the Comptroller, those missing assets were obsolete and moved to warehouse. However, no documentation was on file to document their conditions, movements and approval.
- During our ocular inspection, we encountered fixed assets counted but not in the fixed assets register and had difficulty tracing some assets due to lack of identification or tag number.
- We observed that the documents supporting purchases did not bear approval of the Board although existing policy requires prior approval of the Board before purchasing fixed assets. The President/CEO though approved the purchase requisitions of these assets.
- The Comptroller deleted some fixed assets in the register without proper documentation of the reason and Board's approval. We have noted 105 fully depreciated fixed assets having an acquisition costs of \$2.1M that were not carry forward in the September 2011 Fixed Asset Register.
- We noted that although the existing policy requires the CEO to safeguard assets by means of maintaining insurance programs, it has never been the procedure of the NFC to procure insurance coverage for its fixed assets exposing assets to the risk of damages due to fire and other calamities.
- No records exist to account the fixed assets under the non-operational joint ventures. When requested for the fixed assets register of each of the non-operational joint venture companies, the Comptroller was not able to provide a register or a listing. Thus, we cannot account the type, the valuation, and the condition of those assets under the defunct joint ventures.
- From the review of the general ledger book entries under the accounts for office supplies and office expense for FY 2011, we noted cases of purchases of fixed asset charged to either office supplies expense or office expense instead of accounting them under the fixed assets accounts as follows:
  - ✓ 11/10/10 purchase of 1 unit of cell phone (Samsung Galaxy) for \$693
  - ✓ 01/27/10 purchase of 1 air-conditioner unit (9000 BTU) for \$690
  - ✓ 07/11/11 purchase of 1 computer for \$1,050
  - ✓ 12/13/11 purchase of computer hardware system and printer for \$940
  - ✓ 12/14/11 purchase of cell to NFC President and CEO for \$699

Though not specified in the policy, per the Comptroller the practice was to expense asset purchases below the threshold limit of \$500.

As a result, the Accounting Department is not able to keep track all of the fixed assets for accounting and safeguarding. Furthermore, the management may not be able to detect damage, loss, or theft of fixed assets.

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**Cause and Recommendations**

Management did not implement sufficient policies and procedures to establish accountability and safeguard assets from calamities, theft, or loss.

We recommend that the Management should enhance fixed assets policy to implement fixed assets controls. For example,

- Periodic inspection and reconciliation of fixed assets against fixed assets register
- Implement identification number for equipment, furniture, and fixtures to protect against loss. Such number be included as part of the information in the fixed asset register.
- Formal board approval for purchases, sales and deletion(from listing) of fixed assets
- Protection of fixed assets from fire thru adequate insurance coverage
- Establishing accountability for valuable assets but below the threshold amount for capitalization

We also recommend that the Board should establish accountability for fixed assets at the defunct joint ventures to implement proper security and protection to assets.

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**APPENDICES**

**Appendix A**

Title 24: Chapter 7, Section 706. Corporation authority

- 1) Subject to any existing limitation or limitations hereafter enacted, the Corporation, through its officers and agents, is authorized to engage in all commercial activities which will further the development of the fishing and fisheries industry in the Federated States of Micronesia.
- 2) The Corporation's authority shall include, but not be limited to, the following:
  - a) to enter into joint venture, partnership, and other agreements related to the fishing and fisheries industry with other persons including, but not limited to, foreign persons and governments; (**Profitable Activity**)
  - b) to otherwise engage or participate as owner, partner, shareholder, or other interest holder in commercial ventures related to the fishing and fisheries industry; (**Profitable Activity**)
  - c) to manage or operate commercial projects, enterprises, and ventures related to the fishing and fisheries industry; (**Profitable Activity**)
  - d) to secure both from within and from without the Federated States of Micronesia financial resources to achieve the purpose of this act and the Corporation's charter; (Profit and Non-Profit Activities)
  - e) to provide technical assistance and services for project identification, project formulation, and pre-investment studies relating to the fishing and fisheries industry; (**Non-Profit Activity**)
  - f) to foster economic activities and to cooperate with other institutions within and without the Federated States of Micronesia in supporting activities for fishing and fisheries development; (**Non-Profit Activity**)
  - g) to promote the training of Micronesian citizens in matter related to the fishing and fisheries industry; and (**Non-Profit Activity**)
  - h) to invest in the expansion and improvement of the fishing and fisheries industry in the Federated States of Micronesia (**Profit Activity**)

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**Appendix B**

The Table 1 below shows some examples of what is lacking in the NFC Annual Budget Plan.

<b>Table 1 Basic Contents of an Annual Plan for Profit Company</b>		
<b>Basic Contents in an Annual Plan</b>	<b>Description</b>	<b>ONPA Comments</b>
Sales Forecast and Budget	Sales forecast is prerequisite to devising the sales budget, on which a company can reasonably schedule budget revenues and variable costs.	Not included in NFC's budget
Budget of Cost of Sales	The company forecasts and calculates all the costs associated with the budgeted revenues.	Not included in NFC's budget
Administrative Expense Budget	The company presents how much it expects to spend in support of the sales efforts.	Included in NFC's budget
Budgeted Income Statement	This combines all the preceding budgets to show expected revenues and expenses.	Included in NFC's budget
The Capital Expenditures Budget	This engages in capital budgeting to identify, evaluate, plan, and finance major investment projects through which it converts cash (short-term assets) into long term assets (e.g. fixed assets purchases).	Included in NFC budget
The Cash Budget	This estimates all expected cash flows for the budget period by stating the cash available at the beginning of the period.	Not included in NFC's budget
The Budgeted Balance Sheet	This is a statement of the assets and liabilities, which the company expects to have at the end of the period.	Not included in NFC's budget  Note: NFC is producing actual Balance Sheet for Single Audit purposes.
Budgeted Statement of Cash Flows	This statement anticipates the timing of the flow of cash revenues into the business from all resources, and the outflow of cash in the form of payables, interest expenses, tax liabilities, dividends, and capital expenditures.	Not included in NFC's budget  Note: NFC is producing an actual Cash Flow Statement for Single Audit purposes.

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**Appendix C**

The Table 2 below is the NFC Income Statement for FY 2003-2011.

		(In Thousands)									
		2003	2004	2005	2006	2007	2008	2009	2010	2011	Average
Sales	Amount	\$8,210	\$3,369	\$1,375	\$277	\$98	\$139	\$182	\$232	\$201	\$1,565
	% of Sales	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Cost of Sales	Amount	\$7,582	\$2,949	\$1,269	\$177	\$491	\$32	*\$7	*\$14	*\$13	\$1,393
	% of Sales	92%	88%	92%	64%	501%	23%	4%	6%	6%	89%
Gross Profit	Amount	\$628	\$420	\$106	\$100	(\$393)	\$107	\$175	\$218	\$188	\$172
	% of Sales	8%	12%	8%	36%	-401%	77%	96%	94%	94%	11%
Expenses	Amount	\$1,967	\$817	\$652	\$479	\$396	\$221	\$214	\$266	\$183	\$577
	% of Sales	24%	24%	47%	173%	404%	159%	118%	115%	91%	37%
Total Cost & Expenses	Amount	\$9,549	\$3,766	\$1,921	\$656	\$887	\$253	\$221	\$280	\$196	\$1,970
	% of Sales	116%	112%	140%	237%	905%	182%	121%	121%	91%	126%
Operating Income/(Loss)	Amount	(\$1,339)	(\$397)	(\$546)	(\$379)	(\$789)	(\$114)	(\$39)	(\$48)	\$5	(\$405)
	% of Sales	-16%	-12%	-40%	-137%	-805%	-83%	-21%	-20%	2%	-26%

Source: FY 2003 - 2011 Single Audit  
\*Amount includes Bad Debts.

**Appendix D**

The Table 3 below is the NFC Cash Flow Statement for 2003-2011.

		(In Thousands)									
		2003	2004	2005	2006	2007	2008	2009	2010	2011	Total
Cash Received from Customers		\$8,055	\$2,966	\$1,584	\$104	\$305	\$151	\$171	\$232	\$184	\$13,752
Cash Paid to Suppliers and Employees		10,231	2,936	2,270	219	400	255	223	219	190	16,943
Net Cash flows from Operating Activities		(\$2,176)	\$30	(\$686)	(\$115)	(\$95)	(\$104)	(\$52)	\$13	(\$6)	(\$3,191)
FSM Subsidy		\$231	\$ -	\$100	\$135	\$100	\$135	\$ -	\$ -	\$ -	\$701

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**Appendix E**

The Table 4 below indicates in details the types of incompatible activities done by the NFC Comptroller.

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**Table 4  
Examples of Incompatible Activities**

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Cash Receipt

- Cash receipts or customer payments and preparing cash deposits (custody)
- Recording cash transactions and adjustments in the accounting books - general ledger and customer accounts (recording)
- Preparing bank reconciliation (reconciliation)

Cash Disbursements

- Recording payments in the cash disbursements (recording)
- Having custody of the blank check stock (custody)
- Preparing checks (custody)
- Preparing bank reconciliation (reconciliation)

Payroll Processing

- Approving time cards (authorization)
- Preparing or authorize payroll (authorization). Preparing payroll checks (custody)
- Distributing payroll checks (custody)
- Recording payroll transaction including adjustments (recording)

Fixed Assets

- Recording the transaction (e.g. add, delete, write-off, or dispose assets) in the accounting books (general ledger) and in the fixed asset register (recording)
  - Performing a periodic reconciliation of physical fixed assets to the books (reconciliation)
-

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**MANAGEMENT RESPONSE**



**NATIONAL FISHERIES CORPORATION**  
A CORPORATION OF THE FEDERATED STATES OF MICRONESIA  
P.O. BOX R  
KOLONIA, POHNPEI FM 96941  
email address - psitan@mail.fm/micks 0469@yahoo.com

August 23, 2012

Mr. Haser Hainrick  
National Public Auditor  
FSM National Government  
Palikir Pohnpei FM 96941

Re: 2012 NFC Management Audit Responses to Audit Findings

Dear Mr. Hainrick:

On behalf of the Board and staff of the Corporation, I would like to thank you and your staff for undertaking the Compliance and Management Audit as requested by the Chairman. It is Management's view that the Audit was an absolute necessity as it identified the weaknesses of NFC's Management practices and compliance with normal corporate practices in operating a business. It is also normal that when a new Management take over an operation, an audit is necessary as a way forward reflecting on past and current practices to improve future direction for any Corporation. With those in mind, we believe the audit was done in a professional manner and will contribute to new policy directions which are necessary to move NFC in the right direction. Generally, we agree with the findings and the following are Management's comments to the findings:

**1. Finding 1: "Lack of Strategic Plan to Provide Corporate Direction".**

Strategic Plan for any Corporation is required which set the Roadmap for any corporation and to allocate resources for its implementation. We acknowledge the lack of such plan and we are also mindful of the lack of funding for the Corporation for so many years to develop one. We understand that there was an interim plan but was not implemented fully due to the lack of funding. The Corporation now has some funds and we intend to allocate some funding for the purpose of developing and implementing a plan during FY 2013.

**2. Finding 2: "Inadequate Annual Budget Plan that Failed to Implement Strategies on How to Achieve Goals and Objectives"**

We would like to thank you and your able staff for recommending new elements of a budget plan that would be more appropriate for developing our annual budget process. Given that the Corporation is now operating exclusively from funds generated from its operation activities, we agree that the budget planning should be different from previous ones, when most of its funding was subsidies from the National Government. Our budget plan starting in FY 2013 should takes into accounts the recommendations put forward from this Audit Report.

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**3. Finding 3: "Absence of Performance Measures to Implement and Monitor the Achievement of Goals and Objectives"**

We acknowledged and agreed that indeed NFC has not made the required Reports stipulated under the Statute. Further, Management too often failed to comply with the Bylaws of the Board and the Corporation's owned Personnel, Finance and Administrative Manual. We will try our best to comply with the reporting requirements during FY 2013. With improved computer software, we should be able to generate most if not all the require reports within the required time.

**4. Finding 4: "No Negotiation Process Manual in Place to Promote and Justifiable Decision Making on Joint Ventures and Other Business Undertakings"**

We agreed that prudent practice prior to agreeing to any business investment should include a due diligence study. Those include business plans, feasibility and assessment studies, socio-economic, and environmental studies are prerequisites to assure complete information prior to formally accept a project. No business manager should accept or implement a project without those preliminary studies. Negotiation Process Manual is important for guidance and should be the responsibility of Management to develop one for Board's approval and adoption. We have failed to develop one and this report highlighted the necessity to prepare one for Board's review and adoption. Personally, I recalled that previous NFC's investments, due diligence studies were done prior to the two current ones in operation. For example, MLFC investment that was finance through the ABD, was indeed the most studied investment, but ironically turned out to be the most disastrous investment. We wish to point out that the tuna fisheries industry is a very dynamic industry and some of the investments (CFTI and YFTI) became un-operational when the market went bad and many longline vessels moved out from FSM ports. The two purse seine fishing investments (CFC and YFC), although with different structural arrangements and ownerships are doing very well today, due primarily as a consequent of market improvement and from other regional initiatives. We would agree partially that the \$3.6 million debt to the National Government was a consequence of the lack of Negotiation Process Manual, because a large portion of the debt were for non-profit activities and the rest were caused by factor beyond anyone's control and are characters of the industry as mentioned above.

The two current joint venture investments which the report referred to that decision were based on limited reviewed of proposal, consisting of brochures and letter of intent submitted by interested parties the findings were indeed accurate. The circumstances at the time however, on the decision process for the last two joint ventures, to me were very unusual. The foreign interest partner needed a local partner for preferential access to the regional fishing grounds and NFC needed the cash to continue its operation. The opportunities were excellent with minimum risk and financial cash requirement to generate future revenues and ownership of important fisheries assets. In addition, with time sensitivity, NFC viewed the urgency to conclude the business arrangements as the foreign interests had limited time and would have moved to other countries in the region. And finally, because of the potential good business opportunities, NFC management failed to comply with its own internal approval process and has led to decisions and actions that may be unethical and inconsistent with normal

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business practices and laws. Generally speaking, we concurred with the need for A Decision Process Manual.

**5. Finding 5: "Inadequate Segregation of Duties Led to Undetected Errors"**

We totally agreed with the Finding and it's a management responsibility to ensure minimum risk in financial transaction of any Corporation. It's also the responsibilities of management and staff for full compliance to the Corporate Personnel, Finance and Administration Policy and Procedure Manual. Apparently, they were limited compliance to the Manual. We will take the necessary steps to implement the recommendations.

**6. Finding 6: "Insufficient Control for Payroll Processing Increased the Risk of Abuse and Violation of Law"**

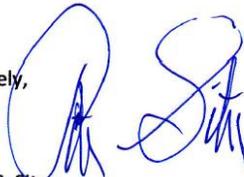
We also agreed with the finding and our response is the same as under Finding 5.

**7. Finding 7: "Insufficient Control and Safeguarding Led to Missing and Unaccounted Fixed Assets"**

We also agreed with this finding and we wish to reiterate that Management and Comptroller were not following the NFC Personnel, Finance and Administration Policy and Procedure Manual. We will take necessary actions to implement some of the recommendations that are not part of the Administrative Manual as your staff pointed.

The above are our comments to the audit findings and wish to take this opportunity again to thank you and your staff for undertaking the compliance and management audit for NFC. We will do everything we can to implement the recommendations put forward by the auditing team. As pointed earlier, this report will guide us to improve our future work and lead to a better future for the Corporation.

Sincerely,



Peter S. Sitan  
President/CEO  
National Fisheries Corporation

xc. Chairman and Board of Directors, NFC

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**ONPA COMMENT REGARDING MANAGEMENT RESPONSE**

The NFC Board and Management generally expressed their agreement to the findings and recommendations provided in this report. They also indicated some corrective action plans that they would implement at their office.

In addition, we would like to make some clarification to the management response to finding number three. The idea of a Negotiation Process Manual is to have transparency on how NFC and potential clients on joint ventures entered into the agreements. Furthermore, the process would allow Board's decision to be made in good faith with reasonable skills and prudence to grant immunity to director and officers for losses incurred in corporate transactions within their authority.

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**NATIONAL PUBLIC AUDITOR'S COMMENT**

We would like to thank the Chairman of the Board, management and staff of the National Fisheries Corporation for their assistance and cooperation during the course of the audit.

In addition to providing copies of the final report to the President and Members of the Congress, we also sent copies to the audited agency. 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 Hainrick  
National Public Auditor

August 10, 2012

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**ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS**

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**ONPA CONTACT:** Haser H. Hainrick, National Public Auditor  
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**ACKNOWLEDGEMENTS** In addition to the contact named above, the following staff made key contributions to this report:

Manuel San Jose Jr., CPA, CGAP, CIA, CISA  
Audit Supervisor  
Elina Paul, Auditor-In-Charge  
Clayton Eliam, Staff Auditor

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