

**AUDIT OF BUDGET OVERRUNS IN SALARIES AND BENEFITS
(FISCAL 2010)**

Report 2011-06



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FEDERATED STATES OF MICRONESIA

Office of The National Public Auditor

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Executive Summary – Audit Report No. 2011-06

Excellency Manny Mori, President
Honorable Members, FSM Congress

The Office of the National Public Auditor (ONPA) announces the release of Report No. 2011-06, Audit of FSM Budget Overruns In Salaries and Benefits FY 2010. A digital copy of the report is available for public review online at www.fsmopa.fm and printed copies are available at the ONPA's offices in Palikir, Pohnpei and Weno, Chuuk. The audit was conducted in accordance with Generally Accepted Government Auditing Standards (GAGAS) issued by the Comptroller General of the United States.

The audit was initiated when ONPA received a letter in October 2010 from the Speaker of the 16th FSM Congress (Speaker) requesting our office to perform an audit of FY 2010 expenditures and the related appropriations, regarding salaries and benefits. The specific concern expressed by the Speaker was that FY 2010 expenditures exceeded congressional appropriations for four entities thus necessitating requests for supplemental appropriations. The four entities named were the Departments of Education (DOE), Department of Justice (DOJ) - specifically the Divisions of Immigration & Labor (I & L) and the National Police (NP), and separately the Coconut Development Authority (CDA). Furthermore, the Speaker asked the ONPA to determine "what truly caused the budgetary overruns and why the overruns were allowed to accumulate to the level it has reached." The purposes requested were put into action with the following audit objectives.

Regarding fiscal year 2010 salary and benefits, our audit was set out to determine:

1. The extent of the budgetary overruns by establishing the dollar amount of total expenditures, the related appropriations and allotments at 9/30/10 prior to special appropriations to cover budget overruns.
2. The primary causes of the overruns and why the conditions were allowed to continue.

Based on our audit, we found that:

- CDA for FY 2010 did not have a budget overrun on salaries and benefits according to documents provided by DFA and SBOC;
- DOE was not able to complete in a timely manner the application for the 2009 Supplemental Education Grant. This lack of timely completion caused a permanent loss of revenue of approximately \$494,240. However, a major budget shortfall for Fiscal 2010 was averted for NDOE only by the use of previously unused 2008 SEG funding of \$143,072 and the activation of unused 2006 grant funding of \$91,405 that was not consumed in earlier years. The activation was a special accommodation by the US Grant Manager which was not normally available since it is a discretionary grant and not Compact funding;

- DOJ: Division of I & L had budget overruns for salaries and benefits of \$130,187 prior to the September 30, 2010 supplemental appropriation. Additionally, FY 2010 Division of I & L salaries and benefits of \$123,238 were charged to FY 2011, which, had the \$123,238 been charged to FY 2010, the total budget overrun (prior to the supplementary appropriations) would have totaled \$253,425;
- DOJ: Division of NP was reported in the financial record for salaries and benefits to be just below or under-budget for FY 2010, however, regular and overtime costs of \$104,212 relating to FY 2010 were not booked and not paid until FY 2011.

In total for the DOJ: Divisions of I & L and NP cost of salary and benefits from FY 2010 amounting to \$227,450 were pushed into FY 2011. As a result, FY 2011 expenditures for personnel costs include \$227,450 relating to FY 2010 for the Divisions of I & L and NP alone.

The Divisions of I & L and NP handled timekeeping and overtime in a casual, hap-hazard manner. Specifically, employees are not keeping detail time records. Instead, supervisors are preparing attendance reports without the benefit of specific time records which then become the basis for the payroll calculations. Additionally, overtime is not managed and there is no documentation of approval until after the overtime obligation is incurred.

The Division of I & L FY 2010 expenditures for overtime totaled \$316,973 which is more than double the amount budgeted, exceeding by 85% the prior year expenditures. The \$316,973 does not include the \$123,238 of FY 2010 overtime cost paid and charged to FY 2011, described above. Thus, the FY 2010 total overtime cost is \$440,211 (316,973+123,238), *which is more than triple the budget*. However, there is also \$91,410 of FY 2009 cost charged to FY 2010.

Ultimately,

- There is a *strategic* lack of timely analyses and reporting of financial performance to budget variances on a monthly and quarterly basis to the Department Secretaries and Managers. In the absence of timely analyses and timely reporting, appropriate action was not initiated until it was too late, e.g. going to Congress multiple times to ask for more money (supplemental appropriations) even as late as January 2011.
- Primary functions regarding DOJ Divisions of I& L and NP, required by the Constitution and Public Laws, were not managed economically, were incurring excessive costs and were not fully funded until supplemental appropriations were made. DFA indicates this cycle has been repeated year after year under various administrations.
- The FSM internal processes leading up to submitting information to the US Grant Manager, particularly for non-Compact grants, must be streamlined to avoid additional instances of lost grant funding. Separately, unused grant funds should also be explained.
- Pushing prior year costs into a subsequent year and obtaining supplemental appropriations are significantly disrupting and defeating the planning, budgeting and reporting of expenditures.

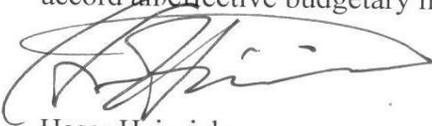
The audit report states that the people of FSM should require and expect its public officials to manage resources efficiently and effectively for maximum delivery of the right services. Compliance with the laws and regulations while necessary and expected is only a bare minimum

standard and not an output / outcome achievement. The best outcome achievement is accomplished when resources are efficiently deployed (e.g. minimum use of overtime) for the effective delivery of services (e.g. protecting the nation) to its people, and of course, in compliance with all applicable laws and regulations.

On a government-wide basis, the Speaker and the President must require more transparency in the reporting of obligations and expenditures by the Department / Office / Agency Heads on a quarterly basis as a means of monitoring budget and expenditure status, not only after year-end, but throughout the fiscal year.

Finally, DOJ has provided its legal analysis to support its position that it is not its (DOJ's) responsibility to ensure that expenditures do not surpass the approved budget for the department but says that this is a responsibility that is legally vested in the DFA. If this is correct, then we suggest that the President and Congress should revisit this policy matter because we believe that, as evidenced by the findings of this audit, it would lead to significant budgetary and accountability issues especially when the Department/Office Heads concerned are not legally responsible for their approved budgets. The Department/Office Heads should have ownership of their budgets, at least in as far as budget tracking and monitoring are concerned, while the responsibility of disbursing and accounting for expenditures remain with DFA, for the efficient and effective accountability and management of budgets.

The appropriation laws designated the allottees of the funds and also assigned to them the responsibility to implement their budgets in accordance with the applicable laws including the Financial Management Act, which prohibits over-expenditure. In as far as the Executive Branch is concerned, the allottee's responsibility which is given to the President would be inherently delegated to the Department/Office Heads who - - considering the structure of the Executive Branch - - keep their hands on the day-to-day implementation of their own budgets. DOJ has spoken on this issue but this is a suggestion from the perspective of what, we believe, would accord an effective budgetary management in FSM.



Haser Hainrick
Public Auditor

July 25, 2011

Xc: Vice President
Secretary, Dept. of Justice
Acting Secretary, Dept. of Finance & Administration
Secretary, Dept. of Education
Acting Director, Office of SBOC

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INTRODUCTION

Background

On September 22 and October 5, 2010, Resolutions #16-129 and #16-131 respectively, were adopted by the Congress expressing grave concerns over multiple alleged violations of the Financial Management Act (FMA) and the Public Service System Regulations (PSSR) by the Executive Branch while urging the President to remove responsible Cabinet Officials.

On October 1, 2010 the Office of the National Public Auditor (ONPA) received a letter dated September 29, 2010 from the Speaker of the 16th FSM Congress requesting this Office to perform an audit regarding FY 2010 expenditures and the related appropriations, specifically salaries and benefits. The specific concern expressed in the letter was that the FY 2010 expenditures by the National Department of Education (NDOE) and Department of Justice- specifically the Divisions of Immigration & Labor and National Police, and Coconut Development Authority exceeded congressional appropriations thus necessitating a request for supplemental appropriations by Congress. Congress had conducted public hearings and received reports that these Departments / Divisions and CDA (the "four entities") had incurred expenditures exceeding the limits authorized by the Congressional appropriation laws.

The media became involved and a Congressional special committee (Committee) was formed, tasked with conducting an investigation on the reasons why there were cost overruns and possible violations of the Financial Management Act of 1979.

The conditions described above made it difficult for the Auditors to obtain good information on a timely basis since employees of the Executive Branch were concerned about their jobs and potential prosecution.

During the course of the audit, the Auditors were called to testify to the Committee on several occasions.

Budget Process

The national government allocates funding levels to programs and services through the budget process each year. Budgeting is one of the most important activities undertaken by the government, and it is an important tool and a focal point for key resource decisions. The budget cycle extends throughout the year beginning with preparation at the department or agency level, review by the Executive Budget Review Committee (EBRC),¹ enactment by the Congress, and execution. Appropriations by Congress are acts of law which provide budgetary authority for departments and agencies to incur obligations and expend public funds.

Once the annual appropriations are developed and signed into law by the President, management is responsible for ensuring their department or agency operates within the budgetary limits that have been established. Budgets for each department or agency are apportioned by Statistics, Budget & Economic Management, Overseas Development Assistance & Compact Management, which reviews apportionment requests, issues advice allotments and enters these into the accounting system. The financial management regulations as described in the FSM Code, Title 55, Chapter 2 govern the budget procedures.

¹ The EBRC is comprised of the Vice President, Secretary of DOJ, Secretary of DFA, and the Director of SBOC

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At the urging of the President, the national government is transitioning the budget process from an operational focus to one that is results oriented. The goal of the performance based initiative is to have budgets formulated with identified objectives or achievement of results. The performance based approach integrates the budget with strategic planning and performance reporting. Integrating annual budgets with the strategic plan will assist in effectively promoting economic growth and self-reliance for the nation.

Objective, Scope and Methodology

Objectives - The audit was conducted at the request of the Speaker of the 16th FSM Congress, and the purpose requested was to determine "what truly caused the budgetary overruns and why were these overruns allowed to accumulate to the level it has reached" regarding specifically the four entities as noted in the letter. The purpose requested was put into action with the following specific objectives.

Regarding fiscal year 2010 salary and benefits; our objectives were to determine;

1. The extent of the budgetary overruns by establishing the dollar amount of total expenditures, appropriations and allotments at 9/30/10 prior to the special supplemental budget appropriations to cover budget overruns.
2. The primary causes of the budget overruns and why the conditions were allowed to continue.

Scope: With regard to the objectives, our audit scope covered Appropriation Laws, Budget Allotments and Payroll Expenditures affecting fiscal year 2010. However, gathering of relevant information included previous and subsequent months for analytical purposes. Our audit was conducted in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States and pursuant to the authority vested in the Public Auditor as codified under Chapter 5, Title 55 of the FSM Code, 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."

Methodology: To determine the extent of the budgetary overruns for the four entities, we obtained financial reports of the approved budgets, copies of appropriation laws, allotment documents, expenditure reports and general ledger adjusting journal entries for FY 2010, prior and subsequent periods.

To determine the primary causes of the overruns and why the condition was allowed to continue we interviewed various employees of DOJ, NDOE, Department of Finance and Administration (DFA), and SBOC.

Prior Audit Coverage

This is the first audit conducted by the ONPA on Budget Overruns in Salaries and Benefits.

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CONCLUSION

Based on our audit, we conclude the following.

DOJ: Divisions of I & L and NP

The Division of I & L -FY 2010 expenditures for salaries and benefits exceeded the original annual appropriation, budget and allotments by \$130,187. A supplemental appropriation was received at 9/30/10 to fund the over-expenditure. However, additional overtime costs for FY 2010 at the Division was not visible (not booked and not paid) until FY 2011, specifically October 2010 for \$40,149 and then in February 2011 for another \$83,089 (See Table 1 and Finding 2).

The Division of NP was reported to be under-budget for FY 2010 however regular and overtime costs of \$104,212 relating to FY 2010 were not visible (not booked and not paid) until FY 2011. If all 2010 regular and overtime costs had been booked and paid in FY 2010, then the Division of NP would have had a budget overrun of \$98,345 at 9/30/10. Instead, the \$104,212 was booked and paid in FY 2011, partly in October 2010 and the remainder in February 2011. (See Table 1 and Finding 2).

In total for the 2 Divisions, cost of regular and overtime from FY 2010 amounting to \$227,450 (\$123,238 and \$104,212) was not booked or paid until FY 2011, approximately half in October and half in February.

As a result, FY 2011 expenditures for personnel costs include \$227,450 relating to FY 2010 for the Divisions of I&L and NP alone.

The Divisions of I & L and NP handled timekeeping and overtime in a casual, hap-hazard manner. Specifically, employees are not keeping detail time records. Instead, supervisors are preparing attendance reports without the benefit of specific time records which then become the basis for the payroll calculations. Additionally, overtime is not managed and there is no documentation of approval until after the overtime obligation is incurred. (See Findings 3 & 4).

The Division of I & L FY 2010 expenditures for overtime totaled \$316,973² which is more than double the amount budgeted, exceeding by 85% the prior year expenditures. The \$316,973 does not include \$123,238 of FY 2010 overtime cost paid and charged to FY 2011. Thus, the FY 2010 total overtime cost is \$440,211 (316,973+123,238), *which is more than triple the budget*. However, there is also \$91,410 of FY 2009 cost charged to FY 2010. (See Table 2 and Finding 1)

The NDOE

The NDOE was not able to complete in a timely manner the application for the 2009 Supplemental Education Grant. This lack of timely completion caused a permanent loss of revenue of approximately \$494,240.

² Each fiscal year, the expenditure total likely includes cost from the prior fiscal year. For example: in FY 2010 expenditures for overtime relating to FY 2009 of \$91,410 were included in the \$316,973. And, the FY 2011 expenditures for overtime now include \$227,450 (123,238+104,212) of DOJ's overtime relating to FY 2010. Basically, when funds are completely used then no further personnel cost is paid (but continues to be incurred). Then when supplemental appropriations are enacted, prior year overtime is booked and paid.

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However, a major budget shortfall for Fiscal 2010 was averted for NDOE only by the use of previously unused 2008 SEG funding of \$143,072 and the activation of unused 2006 grant funding of \$91,405 that was not consumed in earlier years. The activation was a special accommodation by the US Grant Manager which was not normally available since it is a discretionary grant and not Compact funding. (See Table 1 and Finding 5).

The CDA

The CDA for FY 2010 did not have a budget overrun on salaries and benefits according to documents provided to ONPA by the DFA and SBOC. (See Table 1).

Ultimately,

- There is a *strategic* lack of timely analyses and reporting of financial performance to budget variances on a monthly and quarterly basis to the Executive Branch Secretaries and Managers. In the absence of timely analyses and timely reporting, appropriate action was not initiated until it was too late, e.g. going to Congress multiple times to ask for more money (supplemental appropriations) even as late as January 2011.
- Primary functions regarding DOJ Divisions of I & L and NP, required by the Constitution and Public Laws, were not managed economically, were incurring excessive costs and were not fully funded until supplemental appropriations were made. DFA indicates this cycle has been repeated year after year under various administrations.
- The FSM internal processes leading up to submitting information to the US Grant Manager, particularly for non-Compact grants, must be streamlined to avoid additional instances of lost grant funding. Separately, unused grant funds should also be explained.
- Pushing prior year costs into a subsequent year and obtaining supplemental appropriations are significantly disrupting and defeating to the planning, budgeting and reporting of expenditures.

On a government-wide basis, the Speaker and the President must require more transparency in the reporting of expenditures by Department / Office / Agency Heads on a quarterly basis as a means of monitoring budget and expenditure status, not only after year-end, but throughout the fiscal year.

The people of FSM expect its public officials to manage resources efficiently for maximum delivery of the right services. Compliance with the laws and regulations, while necessary and expected, is only a bare minimum standard and not an output / outcome achievement. The best outcome achievement is accomplished when resources are efficiently deployed (e.g. minimum use of overtime) for the effective delivery of services (e.g. protecting the nation) to its people, and of course in compliance with all applicable laws and regulations.

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FINDINGS AND RECOMMENDATIONS

The detail findings including specific recommendations are presented on the following pages.

The audit team's first objective was to determine which of the four entities referenced in the Speaker's letter had expenditures greater than the approved budget.

The information in Table 1 below was compiled from budget, appropriation and expenditure reports and from review of payroll adjusting journal entries including for periods following 9/30/10 to identify expenditures belonging to Fiscal 2010.

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**Table 1
Regular and Overtime Pay With Benefits: Amounts Requested, Appropriated and Expended
Fiscal Year 2010**

Line Item	Description	Immigration ³	National Police	NDOE ⁴	CDA
1	Total Funds Requested by Dept. Secretary (Final)	\$516,799	\$1,053,799	-	-
2	Recommended by President's Office (EBRC)	522,335	1,056,969	-	-
3	Appropriation by Congress for FY 2010(Original)	602,335 ⁶	1,090,381	314,868	71,739
4	NDOE: Usage of prior years' unused SEG funding ⁵ • 2006 SEG Funds Re-Activated 2008 SEG Available Funds	N/A	N/A	91,405 143,072	N/A
5 (3+4)	Total Funding	602,335	1,090,381	549,345	71,739
6	Budget Allotment (Before Supplemental Appropriations)	602,335	1,090,381	549,345	71,739
7	Total Expenditures Booked to FY 2010	(732,522)	(1,084,514)	(516,930)	(70,728)
8	Additional 2010 Overtime Cost Not Booked or Paid Until 2011 (See Finding 2)	(123,238)	(104,212)	-	-
9 (7+8)	Total Cost for FY 2010	(855,760)	(1,188,726)	(516,930)	(70,728)
10 (9-6)	Excessive Cost vs. Budget FY 2010	(253,425)	(98,345)	-	-
11	Supplemental Appropriations: • 9/30/10 PL 16-42 • 10/8/11 PL 16-48 • 1/19/11 PL 16-60 • 1/24/11 De-Allotted ⁷	133,416 41,000 117,980 (41,000)	7,820 66,000 65,148	-	-
12	Total Supp. Appropriations	251,396	138,968	-	-
13(12-10)	Net Cost (Under) Over-Appropriated	(2,029)	40,623	-	-

³In March 2010, Congress approved a pay-rate increase for employees of the Division of I & L and a special appropriation of \$70,560 was enacted under PL 16-25, Section 9- Capital and Human Resources Development. As such, the \$70,560 was allotted to a capital account, and salary and benefit costs for an equal amount were also charged to the capital account. *The expenditures, appropriations and budget allotment totals reported above do not include the \$70,560.*

⁴ NDOE did not incur budget overruns. However, please note that the numbers reported in the NDOE column are approximate.

⁵ Due to failure-to-file the 2009 SEG application by its due date, funds designated for use in Fiscal 2010 amounting to nearly \$500,000 were not acquired; to avert a budget crisis for NDOE in Fiscal 2010, funds available from SEG 2008 (\$143,072) were used and the US Grant Manager authorized the use of 2006 SEG unused funding (\$91,405). See Finding 5 on page 12.

⁶ It is asserted that PL 16-35, the 2010 appropriation for Division of I & L may include a supplemental appropriation of \$80,000 to pay for FY 2009 not paid until FY 2010. The law does not specify this; ultimately it is inconsequential today because it was all applied to FY 2010 expenditures, which did include \$91,410 of FY 2009 salaries and benefits cost.

⁷ The 1/24/11 de-allotment of \$41,000 is satisfactory as follows. Congress approved the initial application of FY 2011 funds to FY 2010 with PL 16-48; however, the actual supplemental appropriation of \$41,000 for FY 2010 was only included with passage of PL 16-60. The de-allotment was to reapply PL 16-48 to FY 2011 on a permanent basis.

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A. DOJ: DIVISION OF I & L

Finding 1: Payroll expenditures in Fiscal 2010 exceeded the original appropriation by \$130,187

Title 55 of FSM Code, Section 221 states the following:

Over-obligation of funds is prohibited. Unless otherwise specifically authorized by law, no officer or employee of the Federated States of Micronesia, or allottee of funds shall make or authorize an expenditure from, or create or authorize an obligation pursuant to any appropriation, apportionment, reappropriation or allotment of funds of the United States Government or the Federated States of Micronesia Government:

- (1) In excess of the sum made available by law; or*
- (2) In advance of the availability of funds; or*
- (3) For purpose other than those for which an allotment has been made*

The approved budget and the amount appropriated for Fiscal 2010 for the Division of I & L was \$602,335 and total expenditures were \$732,522. This resulted in expenditures exceeding the FY 2010 appropriation by \$130,187 (See Table 1: Line 3- Line 7 or \$602,335-\$732,522).

In fiscal year 2010, expenditures for the cost of overtime incurred by the Division of I & L exceeded fiscal year 2009 by approximately \$145,434 for an overall increase of 85%. Table 2 below displays the expenditures for payment of overtime and appropriations, for Fiscal 2010 and 2009.

**Table 2
Division of Immigration & Labor
Overtime Expenditures & Original Appropriations
Fiscal 2010 versus 2009**

Year	Overtime Expenditures	Overtime Appropriation (Prior to 9/30/10 Supplemental)	Overtime Expenditures Exceeding Appropriation
Fiscal 2010	\$316,973 ⁸	\$143,088	\$173,885 / 122%
Fiscal 2009	\$171,539	\$143,088	\$28,451 / 20%
Total Dollar Increase	\$145,434	-	-
Total Dollar % Increase	85%	-	-

The FY 2010 increase of \$145,434 or 85% over FY 2009 was caused by both increased hours and an increase in pay rates.

In March, 2010 Congress approved the pay rate increase for the Division of I & L, and enacted a special appropriation of \$70,560 to pay for the rate increase.

⁸ The \$316,973 expended in FY 2010 for Overtime at Division of Immigration & Labor does not include \$123,238 of FY 2010 Overtime cost that was charged to FY 2011 and paid with supplemental appropriations in October 2010 (PL 16-48) and February 2011 (PL16-60). The FY2010 \$316,973 of expenditures include \$91,410 incurred in FY2009.

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As a result of incurring the excessive overtime costs, Congress approved a supplemental appropriation on September 30, 2010 for FY 2010 Overtime at the Division of I & L for \$133,416.

Causes

1. Increased Overtime Hours

The Division is required to inspect and process various activities including the following:

- a. Inspect all ocean-going vessels, commercial and private, prior to their entry to FSM and again prior to their departing FSM.
- b. Inspect all aircraft upon arrival and prior to departure from FSM.
- c. Process all persons requesting entry or departure to or from the FSM whether from air or the ocean, arriving or departing.

Division personnel are requested to work off-hours during the week, week-ends and holidays and many times employees incur over-time hours that exceeded their regular pay.

While dates and times of arrival or departure of commercial aircraft many times follow a predictable schedule, shipping activities are less predictable.

2. Increased Overtime Pay Rate, Not Funded

Congress approved and funded with a special appropriation an increase in pay rate for the Division that was retroactive to 10/1/09, the beginning of the fiscal year. However, the effect of the rate increase relative to overtime was not factored in and thus was not included in the appropriation. The increased rate for overtime contributed to the overall increase in total cost of overtime, plus it was unfunded until the supplemental appropriations were requested.

The problem of the unfunded increase in pay rates for overtime hours was identified by the Department of Finance in March 2010 but no corrective action was taken.

3. Lack of Management Control

The audit team found:

- a. No evidence that overtime hours were included as a managed component of strategic planning, or short term planning. In fact, there was no evidence of any analyses performed by management as to the economics of incurring overtime on an as needed basis as is currently done, versus hiring additional staff to work during off-hours or week-end and holiday hours. The budget for fiscal 2010 included \$143,088(See Table 2) for overtime, which was the very same amount as fiscal year 2009. No analyses were available as to how the budget amount was determined to be unchanged from the prior year.
- b. No evidence of preapproval of overtime prior to the overtime being incurred. Overtime was approved after the overtime hours were incurred, not before.

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- c. No detail time records were made of the overtime hours. Overtime hours were paid without the keeping of detail start time or end time, and employees did not sign for the hours submitted to payroll. As a result, we could not verify whether the services paid were in fact performed.
- d. Personnel budget are allotted in full to one personnel account category that included both regular salary and overtime. This practice does not help with prudent management control and the need to track/monitor the two separate budget items.

Recommendations

We recommend the Secretary of DOJ perform a personnel analyses of the overall man hours needed per week, per month, per quarter, per year in a scalable model that can be adjusted for projected increases or decreases in economic activity. Include:

- 1. Review past statistics regarding overtime incurred during after-hours Monday to Friday, week-ends and holidays.
- 2. Analyze various options to minimize premium overtime pay-rates; such options may include deployment of multiple shifts (day, evening, night).
- 3. Leave analyses: for annual, sick and holiday time should be included in the total number of man-hours needed per year.
- 4. Develop a plan of operational deployment of manpower.
- 5. Employ the right number of Officers.

We recommend the Director of SBOC only apportion quarterly amounts, e.g. allotments, for all personnel costs. This will avoid budget entities from overspending the full year's appropriation in earlier quarters.

We recommend the Secretary of DFA not make payments if the resulting expenditure will exceed the allotted amounts.

B. DOJ: Divisions of I & L and NP

Finding 2: Overtime costs totaling \$227,450 for June through September 2010 were *not* charged to Fiscal 2010, but were charged to Fiscal 2011.

Accounting principles generally accepted in the US, which is the basis required by the Single Audits, requires:

The cost of all unpaid legal obligations must be accrued in the year in which the obligation was first incurred.

Title 55 of FSM Code, Section 222 states the following:

Over-obligation of funds is prohibited. Unless otherwise specifically authorized by law, no officer or employee of the Federated States of Micronesia, or allottee of funds shall make or authorize an expenditure from, or create or authorize an obligation pursuant to any appropriation, apportionment, reapportionment or allotment of funds of the United States Government or the Federated States of Micronesia Government:

- (1) In excess of the sum made available by law; or*
- (2) In advance of the availability of funds; or*
- (3) For purpose other than those for which an allotment has been made*

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Overtime costs totaling \$227,450 for June through September 2010 was not charged to Fiscal 2010 but was charged to Fiscal 2011. If these costs had been properly charged to Fiscal 2010, then the resulting budget shortfall would be as follows:

**Table 3
Adjusted Fiscal Year 2010 Expenditures & Budget Shortfall**

Line Item	Description	Immigration & Labor	National Police	DOJ Combined
1	Total Expenditures Charged To Fiscal 2010	\$732,522	\$1,084,514	\$1,817,036
2	Add: Fiscal 2010 Costs Charged To Fiscal 2011	\$123,238	\$104,212	\$227,450
3 (1+2)	Adjusted Total Expenditures For Fiscal 2010	\$855,760	\$1,188,726	\$2,044,486
4	Appropriated by Congress	602,335	1,090,381	\$1,692,716
5	Budget Allotments	602,335	1,090,381	\$1,692,716
6 (3-4)	(Over)/Under Expended	(\$253,425)	(\$98,345)	(\$351,770)
7	Supplemental Appropriation 9/30/10	133,416	7,820	\$141,236
8 (6-7)	Post Supplemental Appropriation Shortfall	(\$120,009)	(\$90,525)	(\$210,534)
9	Additional Supplemental Appropriations: <ul style="list-style-type: none"> • 10/8/10 PL 16-48 • 1/19/11 PL 16-60 • 1/24/11 De-Allotted⁹ 	41,000 117,980 (41,000)	66,000 65,148	\$249,128
10 (8-9)	Net Over or (Under) Appropriation	(2,029)	40,623	\$38,594

Charging Fiscal 2010 costs to Fiscal 2011 resulted in:

1. Fiscal 2010 costs were *understated* by \$227,450
2. Fiscal 2011 costs were *overstated* by \$227,450.

Cause

The nonpayment of the June through September 2010 cost of overtime and benefits may have been caused by a desire to keep the request for the supplementary appropriation to only \$141,236 for DOJ. If the cost of overtime and benefits for the June through September 2010 had been included in the Fiscal 2010 expenditures, the total

⁹ The 1/24/11 de-allotment of \$41,000 is satisfactory as follows. Congress approved the initial application of FY 2011 funds to FY 2010 with PL 16-48; however, the actual supplemental appropriation of \$41,000 for FY 2010 was only included with passage of PL 16-60. The de-allotment was to reapply PL 16-48 to FY 2011 on a permanent basis.

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expenditures would have exceeded the budget for fiscal 2010 by an additional \$227,450 for a total \$351,770 (253,425 + 98,345 = 351,770).

The Assistant Secretary of Finance responsible for Payroll states that the DOJ overtime hours with costs amounting to \$227,450 for June through September 2010 was not provided by DOJ to the Department of Finance and Administration (DFA) until the Supplemental Appropriations were passed by Congress partially in October, 2010 but largely in January 2011. Thus, the cost of the overtime, \$227,450 relating to FY 2010, was not recorded in the FY 2010 General Ledger.

The DOJ states that time reports are not with-held but are provided to the Payroll Section of the DFA each pay period regardless of available funds.

Recommendation

We recommend that the DFA accrue all legal obligations to the general ledger in the year in which the obligation was incurred.

We recommend that the President, on a government-wide basis, should require more transparency in the reporting of budget and expenditures by Department / Office / Agency Heads on a quarterly basis as a means of monitoring budget and expenditure status, not only after year-end, but throughout the fiscal year.

We also recommend the Speaker of the Congress to remind all allottees to comply with the requirement for mid-year and year-end reporting to Congress of their budget and expenditure status which is currently a requirement of the law.

Finding 3: Employees may be compensated for time not worked

FMR Part IV Section 4.1 a, requires:

A time and attendance report or other documents satisfactory to the Secretary [of Department of Finance and Administration] ...verifying the days and hours worked by the employee during the applicable pay period.

The audit team reviewed the payroll records at the Divisions of NP and I & L and found that the payroll report was not supported by time records:

1. The biweekly report that is submitted to the Payroll Division is only supported by an attendance report filled out by the shift supervisors.
2. Employees do not sign the attendance reports, and
3. There is no record of actual work arrival and departure times.

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As a result, with the lack of specific supporting records the time reported by supervisors of their employees may not be accurate.

Cause

DOJ management has not made the FMR requirement clear to the Divisions of NP and I & L employees.

Recommendation

We recommend that the Secretary of DOJ should require the Chiefs of the Divisions of I&L and NP to:

1. Implement individual timesheets for each employee to be signed and submitted by all employees and officers which would include date and time of day of all work performed and leave taken, all the time worked for outside contract employers that were coordinated by the office.
2. Consider installing a time clock.

Finding4: Uncontrolled Overtime

Section 8.6 (e) of the FSM National PSSR requires that overtime work must be authorized and controlled in accordance with the following procedures:

- (a) *Overtime should be scheduled and approved in advance, except in unanticipated emergencies.*
- (b) *Overtime must be requested by the immediate supervisor and approved by their superior or the Department/Agency head on a government approved form,*
- (c) *Such overtime work is directed to specific objective or goal which cannot be accomplished during the regular workday, nor postponed to the following day or days.*

The audit team found that approval by the Division Chief is given *after* the overtime is incurred. There was no evidence of overtime being authorized prior to incurring the overtime. The audit team was told that approval is given verbally and sometimes by email and that the emails were subsequently deleted or otherwise not available.

Consequently, it is difficult for a manager to convince an external party that the overtime approved represented the most economical approach in the circumstances.

As a result, overtime hours were paid based on circumstances, not as a thought-out annual planning strategy. There was no evidence of overtime costs being managed for best economic efficiency or effectiveness.

The Division of I & L FY 2010 overtime cost expenditures exceeded the appropriated amount by \$130,187 and if the FY 2010 overtime cost that was charged to FY 2011 were properly charged to FY 2010, then the Division of I & L expenditures would have exceeded its appropriation prior to the supplemental budget by a full \$253,425.

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The Division of NP FY 2010 overtime cost expenditures did not exceed the appropriated amount, however, if the FY 2010 overtime cost that was charged to FY 2011 were properly charged to FY 2010 then the Division's expenditures would have exceeded its appropriation prior to the supplemental budget by a full \$98,345.

Cause

Managers may view overtime as simply a necessary resource to get the job done, placing public service and the achievement of other operational objectives ahead of any conscious consideration for more cost-effective strategies.

Recommendation: Division of I& L, and NP

We recommend that the Secretary of DOJ should;

1. Ensure that all his Division Chiefs comply with the required procedures for overtime as stipulated at Section 8.6 (e) of the PSSR.
2. Require the Chief of the Division of I & L to periodically monitor outside extra duty detail activities to insure that details were worked by the scheduled officer and, if not, that approval was granted for job exchanges and maintain accurate records of time worked and personnel assigned.

C. NDOE

Finding 5: NDOE loss of 2009 Supplemental Education Grant (SEG) of nearly \$500,000 for Fiscal 2010.

The SEG requires certain information to be filed in a timely manner as a pre-requisite to receiving the funding.

Lapses in completing revisions of the NDOE budget resulted in the loss of 2009 Supplemental Education Grant (SEG) funding of \$494,240. The funds would have been available for education purposes to be used in fiscal 2010. SEG are discretionary grants that are not part of Compact Funds and, if not awarded, are not carried over but are returned to the United States.

As a result, \$494,240 which could have been used by NDOE was no longer available.

Cause

NDOE lost control of the process. Deliberations between SBOC and Congress caused delay in finalizing the budget and submission to the Office of Insular Affairs (OIA). The loss of control was exacerbated when OIA requested additional changes. Agreement on the changes was achieved in late May 2009, and the grant manager stipulated a revised budget acceptable to OIA was required to be submitted by July 1. Through a series of lapses, this deadline was not met and, accordingly, the SEG 09 not awarded.

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Notwithstanding the loss of SEG 09 funding, in its search for alternate funding, NDOE discovered there were unexpended SEG funds for 2006 and 2008, which it then utilized for Fiscal 2010 expenditures. This averted a major budget crisis for NDOE.

Recommendation

We recommend that the NDOE Secretary should ensure that all the required budgetary activities from his department are performed efficiently to ensure no interruption to the department's annual funding.

D. SBOC

Finding 6: SBOC internal policies and procedures should be updated

The Office of SBOC is entrusted with "overseeing the preparation and administration of government budget and the nation-wide Strategic Development Plan" also noted on www.sboe.fm.

Internal policies and procedures serve as guidance to the individuals charged with performing these tasks and provide a framework for these key activities and processes. Additionally they establish accountability for essential responsibilities.

SBOC's written internal policies and procedures have not been updated for several years and are not in use by staff. These should be updated and kept current to set forth how to perform such tasks as budget monitoring and reporting, and budget changes.

Documenting internal policies and procedures would provide each staff member with clear directives about assigned duties, thus allowing them to perform the assigned duties with greater accuracy and to completion. For example:

1. Advice of Allotment No. 11N11288 was allotted to the wrong account. Change was made after the auditors brought this matter up with the budget office.
2. Advice of Allotment No. 110N1003 was intended to be allotted on 1/05/10; it was actually allotted 9 months later on 9/30/10. The budget officers explained that allotments entered in the systems at times are reflected but in some cases, an error occurs and it is not reflected. Again, this was not corrected in a timely manner.

As a result, budget analysts did not have the benefit of clear guidance and budget information. For example, budget allotments were not always accurate or current.

Cause

The budget practices internal to SBOC have been developed for the purpose of being in compliance with the law and the principles of managing for results were not incorporated into the budget process.

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Recommendation

We recommend that the Director of the Office of SBOC should update the office's internal policies and procedures for all budget activities and to include all responsibilities of or interactions with other National departments or offices.

E. PRESIDENT'S OFFICE

Finding 7:Lack of budget reporting transparencies to keep the President and Congress well-informed about budgets and expenditures status

The FSM Code (FSMC) Title 55, ¶ 221 prohibits the creation of obligations or expenditures in excess of the funds available by law and ¶ 222 requires, in the case of a violation thereof, the Director of Finance report this to the President and Congress.

In FY 2010 and in prior years, some departments and divisions exceeded their budgets as evidenced by the requests made to Congress for Supplemental Appropriations. The failure by Departments / Agencies / Offices to properly manage their budgets could result in potential violations against the above cited laws.

A comprehensive, consistent, and uniform approach to monitoring budget, actual amounts and variances is not in place, and there is no mechanism to timely detect and prevent a department or division from incurring expenditures or obligations that create budget overruns.

Although most departments and divisions perform some degree of tracking of budget and expenditure amounts, they do not have a convenient or easy access to information in the Fund ware accounting system and they typically perform their reviews using spreadsheets and other software. Moreover, some departments and divisions only track certain parts of their budget.

As a result, the audit team found no evidence that DFA is timely advising the President and Congress of budget overruns. The President and Congress appear to largely become aware of budget excesses when departments and divisions become short of funds and are not able to meet their obligations and/or make payments.

Causes

1. Absence of guidelines and specific instructions regarding the procedures and frequency of reporting budget variances:

There are no guidelines describing the tasks typically to be performed by a budget monitor; how to perform these tasks; and when to perform them. Budget monitors and supervisors throughout the National Government generally are left to develop their own procedures. Poor monitoring of budget information makes it more difficult to properly manage appropriations, allotments and expenditures.

2. Absence of Clear Responsibility for Budget Overruns

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While DFA is the actual "gatekeeper" for payment of salaries and benefits, the Departments that employ personnel are the ones who direct the employees work hours including if or when overtime is worked. Many times a contract exists between the employer (FSM National Government) and the employee regarding payment for hours worked. Thus an obligation may exist when salary and benefits become due for payment to the employee. In other words, multiple persons may be responsible in the creation of obligations that exceed the allotments.

Recommendations

We suggest the President should:

1. Emphasize and require all Department / Agency / Office Heads to provide budget (using quarterly apportionment) compared to expenditures to the President's office on a quarterly basis.
2. Make very clear the overall responsibility of the Department / Agency / Office Heads to ensure their obligations and expenditures do not exceed their allotments throughout the year on a quarterly basis.

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MANAGEMENT RESPONSES



DEPARTMENT OF JUSTICE
FEDERATED STATES OF MICRONESIA
P.O. Box PS – 105
Palikir, Pohnpei FM 96941
Phone: (691) 320-2608 / 2644 Fax: (691) 320-2234

July 15, 2011

The Honorable Haser H. Hainrick
FSM Public Auditor
Office of the National Public Auditor
P.O. Box PS-05
Palikir, Pohnpei FM 96941

Dear Honorable Hainrick:

The following shall be treated as response on behalf of the Department of Justice to the audit report submitted for comments of the Department of Justice:

I. Introduction

On October 11, 2010, the Office of FSM Public Auditor initiated a letter addressed to the Department of Justice indicating that an audit will be conducted on the Department of Justice upon a request made by Congress. A copy of the October 11, 2010 letter is attached as Exhibit A. In a letter dated October 13, 2010, the Department of Justice welcomed the audit in the hope that "your audit will help us understand the budgetary difficulties we encountered in the past fiscal year and provide us with opportunities for improvement in this fiscal year and in the future." A copy of letter dated October 13, 2010 is attached as Exhibit B.

In the same letter of October 13th, the Department of Justice indicated that "[t]o prepare for what DOJ is expected to assist your office with, in the course of your audit, kindly provide me with a description of the nature of the audit, its objectives, and the procedures governing the process. Additionally, as I do not know what particular information or documents you will require from the department, please alert me in advance as to those information and documents needed so that adequate preparation can be made on our part, to expedite your work, and to avoid undue disruption in the daily operations of the department. Also, I appreciate if your office can provide for a copy of "request of the FSM Congress dated 9/29/10".

In response to the above request, the Office of Public Auditor stated in a letter dated October 27, 2010 that at least as of the date of the letter, the Office of Public Auditor "[did] not have a focus objective yet." A copy of the letter dated October 27, 2010 is attached as Exhibit C. The objective will be determined after a preliminary survey has been completed; and after the survey, formal audit objective will be developed and will be discussed (with you) including the nature of the audit, scope and methodologies. It is

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not clear at what point the preliminary survey was completed; and the nature of the audit, the scope and the methodologies remained equally unclear as they were never discussed with the Department of Justice until at the exit conference on June 21, 2011 when the issue of methodology involved in the audit was raised on behalf of the Department of Justice. In view of the absence of clear methodology and lack of transparency as to the nature and scope of the audit, it was not clear how other departments and agencies in the Executive Branch charged of implementing the Financial Management Act was not even mentioned or included in the audit report. For reference, a copy of the draft audit report with cover letter dated June 10, 2011 is attached as Exhibit D; while a copy of the revised audit report with cover letter of June 27, 2011 is attached as Exhibit E.

II. Clarity, transparency and predictability in the audit process

Section 507, title 55, of the FSM Code requires, to wit: "The Public Auditor shall perform audits in conformity with generally accepted audit standards as established by the American Institute of Certified Public Accountants." On the other hand, the audit report states that "our audit was conducted in accordance with the standards applicable to performance audits contained in Government Auditing Standards issued by the Comptroller General of the United States pursuant to the authority vested in the Public Auditor as codified under Chapter 5, Title 55 of the FSM Code." First of all, the relevant funds appropriated for the Department of Justice are not Compact or US funds, hence, it is rather incongruous how US audit standards issued by the Comptroller General of the United States would have overreaching application to the use of local funds of the Federated States of Micronesia. Regardless, in my view the procedures for government audit should afford a certain degree of transparency to the entity being audited. It bears reiteration that the letter from the Office of Public Auditor dated October 27, 2010 (Exhibit C) alluded to a formal audit objective which shall be developed after a preliminary review and which would be discussed with the Department of Justice. Again, the audit objective is unclear at that point in time – as it was not disclosed – as to how it was developed; and if there was a formal audit objective, it was not discussed with the Department of Justice until several months after when the exit conference took place in June 2011. It becomes a serious issue of transparency and predictability in the whole audit process. The Department of Justice requested for "a description of the nature of the audit, its objectives, and the procedures governing the process. Additionally, as I do not know what particular information or documents you will require from the department, please alert me in advance as to those information and documents needed so that adequate preparation can be made on our part, to expedite your work, and to avoid undue disruption in the daily operations of the department." None was made clear to the Department of Justice despite the reasonable expectation to be provided with the requests as reasonably made.

III. Independence of the Office of Public Auditor

As the audit report bears, *during the course of the audit, the Auditors were called to testify to the Committee (in Congress) on several occasions.* The constitutional guarantee of independence of the Office of Public Auditor may have been unwittingly

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compromised. The audit report was triggered by a request from Congress after Congressional Resolution No. 16-129, expressing grave concerns over multiple alleged violations of the Financial Management Act (FMA) and the Public Service System Regulations (PSSR) by the Executive Branch and urging the President to remove responsible Cabinet Officials. Another Congressional Resolution No. 16-161 passed by Congress created a Special Committee in Congress to investigate the allegations made in Congressional Resolution No. 16-69. No doubt Congress has the constitutional right and duty to inquire upon the conduct of the executive branch *in aid of legislation*. As it is a duty to preserve the independence of the Office of Public Auditor entrenched in the constitution, and given the fact that the audit was, in the first place, requested by Congress, the participation of the Office of Public Auditor as witness in congressional hearing during the pendency of audit investigation could have created an impression of impropriety, which in turn casts doubt – perhaps unfairly so – on the quality and independence of what ultimately is a final audit report. As will be discussed hereunder, the accuracy of the results of the audit and the findings contained therein became questionable, to the disappointment of the Department of Justice, which has indicated willingness to learn from the causes of the budget shortfall to aid in its internal investigation as to the contributing factors leading to the budget problem, in the hope of avoidance of its repetition in the future.

IV. Scope of methodologies

The scope of methodologies failed to take into consideration the fact that financial expenditures of the Department of Justice, as is true for other departments in the national government, are held and kept in the Department of Finance and Administration. The Financial Management Act places the responsibility of recording and auditing the disbursement of money from the National Treasury in the Department of Finance:

55 FSMC § 205. Secretary of Finance — Accounting duties.

(1) The Secretary of Finance of the Federated States of Micronesia shall be the general accountant of the General Fund of the Federated States of Micronesia. He shall record and audit, or cause to be recorded and audited, every receipt and disbursement of money paid to, by, or through the National Treasury of the Federated States of Micronesia. He shall have full and complete supervision of all funds of the Federated States of Micronesia, including the power to withhold his approval when necessary to prevent misappropriation of public funds as well as the disbursement of public moneys in excess of specific appropriations.

The duty of the Department of Justice is to certify to the Department of Finance as to the quality and the quantity of the services rendered by the employee to the satisfaction of the National Government. This certification by the Department of Justice comes in the form of timesheets. It then becomes the duty of the Department of Finance and Administration to pay for the services of the quality and quantity rendered to the national government. For further discussion on this point, see Exhibit F which is a letter dated

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March 12, 2011 from the Secretary of the Department of Justice to the Honorable Vice Speaker of the 16th Congress of the Federated States of Micronesia. The letter constitutes a supplemental response to the Congressional Resolution No. 16-129.

Because the audit report ignored this important provision in the Financial Management Act, the audit report is already misinformed from the beginning. The conclusions arrived at also failed to consider the role played and the duty that must be performed by the Department of Finance. The audit report suggested that this omission will be addressed in a footnote; this point is sorely missed.

The audit report simplistically implied that since the expenditure exceeded the money appropriated for personnel, then the Department of Justice is in violation of the Financial Management Act. Again, the submission of timesheets is not the expenditure which is effected only obligation is booked and checks are cut in payment for obligations. Personnel expenditures include salary payments to employees, tax deductions, social security payments (both employee's share and employer's share). The amounts of these payments are all controlled not by the Department of Justice.

V. The duty to manage expenditures

Currently, the Department of Justice does not have, and is not vested, the legal capacity to fully manage its personnel expenditures. The Financial Management Act assigns the duty to "record and audit, or cause to be recorded and audited, every receipt and disbursement of money paid to, by, or through the National Treasury of the Federated States of Micronesia." 55 F.S.M.C. 205. For this reason, the Department of Finance and Administration is delegated the duty to promulgate regulations to implement the Financial Management Act. See, the Financial Management Regulations. In the case of

It is willing to assume this duty is vested by law, provided that appropriate financial support is provided.

It is recalled that for fiscal year 2010, \$30,000 was appropriated just for the maintenance of the Financial Management Information System (FMIS). The same amount was appropriated for fiscal year 2011. This system is designed to keep track of the disbursement of funds in the Department of Finance. In addition to this, an expert contractor was hired to dedicate her services to the perfection of this system.

Despite dedication of financial resources of the national government to the perfection of the FMIS, the FMIS admittedly failed to monitor the expenditures and failed to raise a red flag when the appropriation was exceeded. The Department of Finance calculates how much are to be deducted from the personnel budget for payment of taxes, social security, allotments of employees, life insurance, medical insurance (MICARE), employer's contribution and in general the fringe benefits. These intricate financial calculations are vested in the Department of Finance. The Department of Justice is willing to assume this obligation if the cost of building financial capacity is approved by law. Until that legal duty is vested on the Department of Justice, the Department of

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Justice is not responsible for an omission of an act the performance of which is vested upon another department in the national government.

The employees in the Department of Justice – in particular the Division of Immigration and Labor and the Division of National Police – are governed by their respective contracts with the national government. The contract consists of the performance of certain services on the part of the employees to the satisfaction of the national government. Once the services are performed to the satisfaction of the national government, it becomes the duty of the national government to make payment for the services. This is the principle of mutuality of obligation.

The duty of the Department of Justice is to certify that the services performed are of the quality and quantity as are satisfactory to the national government. The Department of Justice certifies the quality and the quantity of services performed to the national government through the submission of timesheets. See, Exhibit F for further discussion on this point.

VI. A policy decision on overtime

The audit report states that "there is no evidence that overtime hours were included as a management component of strategic planning." The report further alludes to hiring of additional staff instead of incurring overtime. What is obviously missed in the report is the fact that these matters constitute legislative policy that rests upon the purview of Congress. The number of employees that can be hired by the executive branch is dictated by law. The Department of Justice cannot exceed the number personnel assigned to it. Also, the ability to incur overtime is provided by law. Overtime is allowed only to select agencies in the national government. At least for the Division of Immigration and Labor and for the Division of National Police, the urgency of their respective work in securing the border and the safety of the Nation, are perhaps the motivating consideration for allowing the relevant personnel overtime compensation to ensure their availability in times of need. Again, these are policy considerations which cannot be changed by the Department of Justice alone. It requires at the very least re-examination of relevant legislations – in particular title 50 and title 52 of the FSM Code.

What is rather disturbing as can be implied in the audit report is that at some point the personnel in the Division of Immigration and Labor and personnel in the Division of National Police must stop incurring overtime work if there is no longer available overtime fund. The duty to secure the border in view of international travel and international commerce cannot be made to depend on whether Department of Justice has overtime fund. The national police officers are not relieved of their legal duty to secure the peace and order of the nation or from undertaking emergency or unplanned activities upon instruction of the President just because the overtime fund is exhausted. The duties are provided by law, and the obligations vested upon the relevant personnel in the Department of Justice remain and must be performed to the satisfaction of the national government. It is a legal obligation of the national government to pay for the services rendered.

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The payment of services performed by Immigration and National Police Officers cannot be likened to procurement of office supplies or procurement of goods. If the money appropriated for office supply, equipment or goods is exhausted, then the department must stop further procurement. Quite differently, securing of the national borders and the maintenance of peace and order are an exercise of police power of the national government. They are inherent in government regulation to maintain public order and safety.

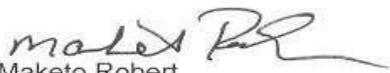
VII. Conclusion

As indicated before, the Department of Justice is eager to understand the causes of the shortfall and wants to do so with the assistance of the Office of Public Auditor. Nonetheless, the Department of Justice finds it to be in the best interest of the FSM national government to fully analyze the matter taking into consideration not only the superficial symptoms of the financial problems, but their deeper justifications as well.

Per your communication of June 27, 2011, I anticipate that the comments of the Department of Justice herein explained will be appended to the final audit report.

Please let do not hesitate to let me know if you have any questions.

Thank you.


Maketo Robert
Secretary, FSM Department of Justice

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THE FEDERATED STATES OF MICRONESIA
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July 4, 2011

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

Dear Mr. Hainrick:

I am pleased to extend our gratitude and appreciation to you and your able staff for affording us the opportunity to comment on the Draft Audit of the Budget Overruns in Salaries and Benefits.

First, let me thank you for your positive comments on the new Integrated Planning and Budget (IPB) manual, which has been developed and is pending the provision and integration of a Budget Module on the FMIS System for implementation. As pointed out during the conference, the IPB will be implemented, not only at the national level, but at the state level as well. Under a technical assistance (TA) from the ADB, the necessary trainings on the IPB were conducted and completed for the four states and the national government before the end of FY 2010. Actual implementation will commence upon the completion and integration of the Budget Module, provision of which has been delayed and protracted for far too long. This aspect of the project is an integral part of the FMIS, which is currently being contracted out to a vendor by the Department of Finance & Administration. The IPB will give us the necessary integrated budget and planning system and update procedures needed for budgetary controls, monitoring and improved fiscal discipline for all 5 governments.

On the 2 specific recommendations for SBOC, we welcome the recommendations or any constructive feedback that could assist in directing us toward the overall improvement of our process and systems with the end view to better serve our constituents; that is, the people of this great country of ours. Following are our comments:

1. SBOC to apportion and allot only quarterly amounts for all personnel costs. We are in accord with this recommendation given the need to allow more control and better handle on the management of funds for such cost category for all agencies. It is our view that this should not only be limited to personnel costs, but should also be applied to other cost categories that required specific activities to be implemented over the 12-month budgetary cycle. There are some activities that have a single occurrence, hence necessitate a lump-sum or incremental disbursement of cash outlay over a relatively short period. The executing agencies should be able to determine these activities, and consequently advise SBOC of the timing of allotment issuance.
2. SBOC to update written internal policies and procedures. While there is currently no Budget Manual of Operation given our short existence, we have bits and pieces of procedures and

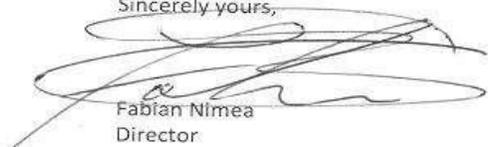
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policies that have been utilized over the years and during previous administration for internal control. It is one of the reasons why we had made every effort to ensure we develop and produce the aforementioned Integrated Planning and Budget Manual. However, our Division of Budget & Economic Management has internal Work Plan that delineates specific duties and responsibilities for each of the staff, especially on the budgetary process such as apportionment, issuance of quarterly allotments, as well as the Administrative Control of Funds. As you may have known, about 3 years ago we introduced the concept of *Budget Instruction* that spells out the specific steps toward the formulation and development of the Budget. This is the first for the National Government and usually comes with the Budget Call, which is normally issued on November 15th of each fiscal year. This, too, will complement the IBP and other policies and procedures that will be developed to improve and enhance administration control of funds for the FSM National Government.

In closing, we wish to note that we think the comments that, "budget allotments were not always accurate or current" is not supported by anything in the report. Nowhere in the Audit report do we find anything to show that any of the budgetary overage was caused by or directly linked to the inaccuracy of allotments. Table 1 of page 6 of the draft Audit Report illustrates this case in point.

Thank you again for the opportunity to comment and respond to the Audit Report.

Sincerely yours,



Fabian Nimea
Director

Office of the National Public Auditor
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Secretary of Finance
&
Administration

GOVERNMENT OF THE
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July 6, 2011

Mr. Haser H. Hainrick
National Public Auditor
Office of the National Public Auditor
FSM National Government
Palikir, Pohnpei FM 96941

Dear Mr. Hainrick:

We wish to thank you for giving us the opportunity to respond to the Budget Overruns in Salaries and Benefits audit report we received on June 28, 2011. Please find below our response to each of the findings indicated in the report as follows:

1. Payroll expenditures in Fiscal Year 2010 exceeded the appropriation amount by \$130,187.

Response: We disagree with the audit finding statement that the payroll expenditures in Fiscal Year 2010 exceeded the appropriation amount by \$130,187 simply because the statement is incomplete and does not represent the final statement at the close of Fiscal Year 2010, however, we do agree if the audit finding would state "Payroll expenditures in Fiscal Year 2010 exceeded the original appropriation amount by \$130,187."

During FY2010, the original appropriation for salaries and wages with benefits for the Division of Immigration and Labor was \$602,335 with a reported expenditures of \$732,522 resulting to an overrun of \$130,187 (see table 1) however, on September 2010, to cover the overrun, supplemental appropriation was made thru Public Law No. 16-42 in the amount of \$133,416 thereby, as at FY2010 ending September 30, 2010, payroll expenditures in Fiscal Year 2010 do not exceed the appropriation amount.

During FY2010, the appropriations for both personnel and overtime were allotted as a single line item into personnel category without allocating the budgeted amount for each of the personnel and overtime. The commingling in the issuance of allotment of personnel and overtime into one budget account category

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makes it difficult for the national treasury to determine the amount spent of each of the salaries and wages and overtime. Other causes of the overrun from the original appropriation were clearly identified by the ONPA on page 8 of this report.

In FY2011, corrective action has been made by the FSM Department of Finance and Administration and the Office of SBOC by allocating the budget amount for personnel and overtime separately thereby making it easier for the national treasury to monitor the overtime expenditures of the Division of Immigration and Labor and other Divisions of the Departments.

As to the recommendation of the ONPA, we agree with the recommendation that the Secretary of Department of Finance and Administration should not make payments if the resulting expenditures will exceed the allotted amounts.

2. Overtime costs totaling \$227,450 for June through September 2010 were not charged to Fiscal year 2010 but were charged to fiscal year 2011.

Response: We do agree with the audit finding that the overtime costs totaling \$227,450 in FY10 were not charged to Fiscal Year 2010 but to Fiscal Year 2011. Additionally, we also agree in the recommendation that all unpaid **legal obligations** must be accrued in the year in which the obligation was first incurred.

However, in the case of overtime mentioned above, we believe that this cost at the end of September 30, 2010 of FY2010, is not a legal obligation of the national government thereby should not be accrued in the FY2010.

There are criteria in determining before a transaction is considered a **legal obligation** of the national government. **First**, there must be a Congress appropriation and allotment advice issued in the case of a transaction funded by the domestic revenue and/or a grant in the case of federal/foreign grants funded by US and foreign countries, **Second**, the transaction must be in writing and authorized/approved by the appropriate allottee, and **Third**, it must be certified by the Secretary of Finance and Administration or its designee as to the availability of funds. Lacking one of these criteria does not meet the legal obligation of the national government and becomes an invalid obligation hence should not be accrued in FY2010. Additionally, accruing the above overtime costs will result to an over obligation of funds which is against the Title 55 of FSM Code, Section 221.

The national treasury is in a dilemma wherein two guiding principles and laws that contradict to one another but both have to be considered in addressing a particular transaction. One is the accounting principles of generally accepted in the USA that requires **accrual of legal obligation** but the accrual would result to over obligation and the other one is Title 55 of the FSM Code, Section 221 which **prohibits an over-obligation**.

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The result of the FY2010 single audit report performed by Deloitte & Touche' has made a passed adjustment relative to the above overtime meaning the auditor did not make an adjustment to record the accrual of the above overtime in FY10 because it was determined that the amount is below materiality and by not accruing the above overtime, it will not affect the result of the financial statement of the national government as a whole. Additionally, the Public laws nos. 16-48 and 16-60 have appropriated the overtime of FY2010 in FY2011.

After what happened in the payroll overrun in FY10, the Secretary of Finance and Administration called a meeting to discussed on the corrective action that needs to be addressed in-order that such payroll overrun will not happen in the future. Among the corrective actions made by national treasury are as follows:

1. The operations manager to monitor all funds balances most specifically the payroll balances.
2. The payroll manager will closely monitor the personnel fund balance of each department prior to processing the payroll and after the posting of the payroll expenditures to the accounting system.
3. The information technology (IT) section has developed a payroll estimated budget requirements report that will monitor the payroll expenditures every posting of pay period and will provide a projection of budget requirement based on salary expenses to date. Essentially it is a rough estimate of how much the department will need if they continue to spend at the current level. The report will allow the national treasury to notify the department if it appears that they may have a payroll budget shortfall. The report consists of the annual budget; total expenses to date, the fund balance, the average budgeted per pay period, the average expensed per pay period, the estimated payroll funds required and the variance. The report can be printed at any given time upon the request of the department, offices, or agency. The plan is to provide access to each of the department to run the report for their department with detail by division. Please refer to the attached report.

Sincerely,



Rose N. Nakanaga
Acting Secretary, Department of Finance & Administration

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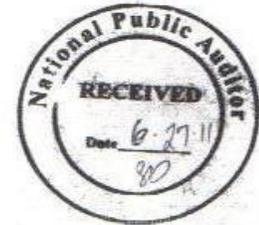
**FEDERATED STATES OF MICRONESIA
DEPARTMENT OF EDUCATION
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June 24, 2011

Mr. Haser Hainrick
National Public Auditor
Palikir, Pohnpei FM 96941

Haser
6.27.2011



SUBJECT: AUDITEE'S RESPONSE

It gives me great pleasure to be given this opportunity to respond to your audit findings and recommendations reflecting Congressional Resolution #16-29 as indicated in your draft special audit report. The report fairly addressed the issue that triggered the audit to be conducted; however, in addition to your audit findings I am hereby offering the following concerns itemized below:

1. Audit Finding 5: NDOE loss of 2009 SEG (Supplemental Education Grant) of nearly \$500,000 for FY2010.

The submission of NDOE FY2010 budget comprised mainly of two funding streams (ESG for \$603,240 and SEG for \$494,549) which carry the bulk of NDOE fiscal year operation. It must be noted that SEG portion of NDOE Budget of \$494,549 never realized because the approved revised NDOE Integrated Plan was submitted rather late.

It should be understood by all concern that our annual Integrated Plan has never been acknowledged as part of our local approval process. However, this is an add-on requirement by OIA that must be endorsed by FSM Congress and channeled to SBOC for official submission to OIA.

The current practice for a budget approval process under the current administration seemed to single out Office of SBOC as an office to liaise between the National Government and OIA. NDOE acknowledged SBOC as a clearing office in a budget approval process either internally or externally. It is my understanding however, that for any budget revision, adjustments and/or modification must be channeled through SBOC or vice versa to make it official.

2. Finding 7: Ineffective monitoring and control over budget variances.

Paragraph four (4): NDOE partially dispute the last sentence on paragraph 4; "NDOE officials, for example, represent they do not track any budget amounts for salaries and benefits." With all due respect staff responsible for tracking expenditures, periodically monitors the status of NDOE personnel cost category (expenditures) to ensure that

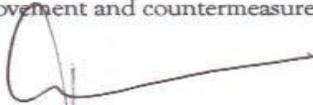
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National Public Auditor
June 24, 2011
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funds are available to cover salaries and benefits for a given pay period. We also acknowledge that a "log" to track personnel costs and benefits has not formally instituted; however, we periodically monitor NDOE personnel expenditures between pay-weeks to ensure funds availability.

To resolve the issues and recommendation offered in your special audit, I have today assigned and direct the *Quality Control Unit* within the FSM Department of Education to review issues surrounding personnel costs and recommend establishment of policies to rectify the sited recommendation from happening in the future audits.

Thank you and your able staff, for candidly addressing NDOE management issues for improvement and countermeasures of few recommendations.



Casiano Shoniber
Secretary, NDOE

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ONPA COMMENTS REGARDING MANAGEMENT RESPONSES

A. Department of Justice

As the audit has revealed, there is room for improvement in the planning, management, and implementation of the DOJ's budget. For example,

- DOJ's budget request for FY 2010 was less than the amount recommended by the EBRC, and Congress appropriated more than it was recommended (and requested). Even though it received more than it requested, the original appropriation still was not enough to cover all its expenditure requirements for 2010. In its letter of March 12, 2011 to the special committee chairman, DOJ argued that it incurred the (alleged) problems with budget overruns because its approved budget was less than the amount requested. However, our audit has found that DOJ's approved budget for 2010 was more than the amount which DOJ requested (refer to Table 1). In other words, DOJ requested less than it required.
- DOJ's 2010 budget for overtime remained the same (\$143,088) as for 2009 even though its actual 2009 overtime expenditures far exceeded the budget. Additionally, the Department knew that more activities were required in 2010 yet its budget for 2010 overtime did not correspondingly increase with the anticipated rise in services (refer to Table 2).
- Increases in pay rates were approved but the budget did not factor in the effect of the pay rate increases for overtime hours.
- Lack of analyses for overtime pay; approval of overtime hours after they were incurred (not beforehand); and lack of sufficient detail records to support payment of overtime hours.

Ownership was lacking therefore DOJ disowns its responsibilities over its budget.

In its response, DOJ says it is not its responsibility to ensure that expenditures do not exceed its budget but, rather, it says that this is the responsibility of DFA. DOJ provided its legal analysis to support this position.

Departments/offices within the government create and produce their own budget. After the approval of their budgets, then they move on to budget execution by implementing the programs/activities. Departments/offices should own their budget; meaning, ownership in terms of tracking and monitoring their budget and in establishing the necessary mechanisms to be able to internally perform these tasks within the department/offices. Budget responsibility and accountability is vested in the Department concerned. They should not create and implement the budget and then say that it is someone else's (in this case DFA) responsibility to ensure that expenditures remain within the approved budget. While DFA has the authority to withhold payment to prevent budget overruns, the executing Department as the implementing agency holds the first responsibility to operate within its budget limits. The Department should track its budget to prevent budget overruns. The role of the department's administrative officer has to be heightened to assist in tracking budget status and expenditures, thus effectively serve as the accountant for the department in order to assist the Department Head not to incur or obligate more than its approved budget.

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Our audit recognizes the Department's enormous duties and responsibilities to provide police services and border controls for the nation. In addition, our audit suggests that appropriate budget planning and resource analyses are essential for the Department to use. Our audit did not suggest that the Department's immigration and police services should be ceased if funding is lacking. Right-sizing merely means that the Department should have the right number of employees. We expect DOJ to already know that all hiring and decisions should be done in compliance with the law. The audit report is written from the perspective that there is opportunity for the Department to improve its deployment of officers by using better management planning.

The Department's response further implies that the independence of the Office of Public Auditor was compromised as a result of being called to testify to the Congressional special committee on several occasions. We guarded the independence of the Office with jealous and zeal ensuring that our judgment is not impaired during the course of the audit. We also recognized that, when called to appear before the special committee, we were required to comply. There was no substantive discussion of specific audit issues but rather most of the discussion focused largely on audit status and timing to complete the audit - - recognizing the many issues which contributed to its delayed completion.

The Department also raises issues about lack of clarity, transparency and predictability in the audit process for failure to inform the Department about the audit objectives, audit scope and methodologies, and the audit requirements (records, data and other information).

In our letter dated October 27, 2010, we notified the Department about our audit objectives. In part, we stated that "..... the specific purpose of the Congress in requesting the audit was to determine what causes the budgetary overruns for Personnel budget and why these overruns were allowed to accumulate." The scope of the audit was clearly spelled out in Resolutions by Congress, copies of which were widely available to everyone. Nonetheless, we strive to maintain an open line of communication with the entities that we audit in order to answer questions and to maintain transparency.

The Department further implies that the audit did not comply with the law because we used the standards applicable to performance audit issued by the Comptroller General of the United States contrary to the Public Auditor's Act which requires the Public Auditor to conduct audits in conformity with generally accepted auditing standards as established by the American Institute of Certified Public Accountants...." The Department may not understand that by using the generally accepted government auditing standards (GAGAS) which are issued by the Comptroller General of the US, also known as Government Auditing Standards (GAS), we are complying with the generally accepted auditing standards (GAAS) established by the AICPA. Since this is a performance audit on budget overruns in a government environment, the GAGAS standards were more appropriate to use rather than the AICPA standards of which the later are more fitting to use for auditing small, non-government, private operations by CPA's performing audits for the purpose of expressing an opinion on the fairness of the financial statements. Also, GAGAS holds auditors and audit departments to high standards of performance.

The Department further comments that "the relevant funds appropriated for the Department of Justice are not Compact or US funds, hence, it is rather incongruous how US audit standards issued by the Comptroller General of the United States would have overreaching application to the use of local funds of the Federated States of Micronesia." As a country that uses US accounting principles to account (record, summarize,

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analyze and report) for its funds, it is also right to use the US auditing standards to audit the use of those funds - - whether local or US sourced funds. Perhaps this is the same application in the legal spheres as well like, for instance, where there are no local case laws to support a legal analysis, lawyers then resort to using US case laws because ours is a country which was built on the US model.

If an issue was raised against the use of GAGAS because they were auditing standards issued by the US Comptroller General, then one would assume that, by extension, the Department would also find fault against the Public Auditor's Act for requiring the Public Auditor to use the auditing standards promulgated by the AICPA, which is another US authority - - basing its argument that the Department expends local funds not US funds. However as it relates to this case, we don't see any problem using the US auditing standards to audit the Department's funds.

(Note: The exhibits in DOJ's response are not included here but copies can be provided by ONPA if requested.)

B. Office of SBOC

The Director of the Office of SBOC agrees with the report findings and recommendations. The response includes a considerable amount of additional information regarding the Integrated Planning and Budget manual.

The last paragraph of the response also states "In closing, we wish to note that we think the comments 'budget allotments were not always accurate or current' is not supported by anything in the report." We have added a few examples in the body of the Finding to support our statement.

C. Department of Finance and Administration

In response to the Acting Secretary of DFA observation that the Finding 1 title: *Payroll expenditures exceeded the appropriation by \$130,187*" should make it clearer that it is the original appropriation referenced, we have now added the word "original" to the title to be as follows: *"Payroll expenditures exceeded the original appropriation by \$130,187."* For FY 2010 the original appropriation was the only appropriation until 9/30/10 when the first supplemental appropriation was enacted by Congress.

DFA allowed the disbursements which resulted in the over-spending of DOJ's budget during FY2010. It was only through the supplemental appropriation that was passed by Congress on 9/30/2010, signed into law by the President on the same day, and with the advice of allotment issued at 4:00 p.m. that the additional funding was kicked in at the eleventh hour and then the general ledger was closed showing a balance amount. Otherwise up until the supplemental funding, there was a budget overrun.

D. Department of Education

The Secretary of Education agrees with audit finding 5 which is specifically regarding DOE. Audit Finding 7, which included reference to NDOE in the first draft was revised and there was no mention of NDOE in the final draft. It was the ONPA intent for the Secretary to respond to the final draft.

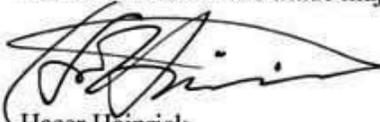
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NATIONAL PUBLIC AUDITOR'S COMMENTS

We would like to thank management and staff of Departments of Justice, Education, Finance & Administration, Office of SBOC, and Coconut Development Authority 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 departments. 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

July 25, 2011

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Audit of Budget Overruns in Salaries and Benefits
Audit Report 2011-06**

ONPA CONTACT AND STAFF ACKNOWLEDGEMENTS

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

Ron Sufficool, CPA, CISA, CIA, CFE, CMA, Audit Manager
Erwihne David, Auditor-In-Charge
Mermina Mongkeya, Staff Auditor
Elina Paul, Staff Auditor

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